BUSINESS ORGANISATION

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LAWRENCE R. DICKSEE

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BUSINESS ORGANISATION

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PREFACE

THIS handbook is founded on a course of Lectures on "Business Organisation," delivered at the London School of Economics and Political Science in the early part of 1909. Its object is to indicate the connection between the abstract sciences of economics, of currency, of accounting, and the like, and practical business operations. Having regard to the magnitude of the task and the necessary limitations of space, it follows that the treatment of the subject is extremely superficial. It may be pointed out, however, in extenuation, that it is not really intended that it should be anything else. The object of the work is to indicate the points of contact between academical study and actual business, in the hope of imparting some reality to the researches of the theoretical student, and of encouraging the practical man to believe that the sciences already referred to may possibly have something to teach him.

It remains, of course—and must necessarily remain—for the practical reader to apply the general principles touched upon in this work to concrete cases, to enable him to derive any practical profit from their study. The suggestion put forward is that it may be possible for him to benefit by acquiring more scientific methods,

which will enable him to apply to his own particular case the experience of others in the past. In applying that experience, however, it must be remembered that in almost all cases it will require to be modified to suit the altered conditions. It is, no doubt, a perfectly true saying that history is continually repeating itself; but it invariably repeats itself with a difference. Precisely the same thing never happens twice in actual life; consequently one must not rely too much upon precedent, or past experience, as a guide to the future. But, if one has studied the history of the past sufficiently thoroughly to understand why it came about—why it became history—one stands at all events a fair chance of forming an accurate judgment as to how, given different conditions, the same forces are likely to operate in the present, or in the future. In that way—and, it is submitted, in that way alone—is it possible to be prepared for events.

It is, of course, not sufficient to foresee what will happen in the future, for in the course of time almost everything will happen. To derive any profit from such calculations it is necessary, at all events within certain limitations, to be able to perceive when the particular change that one has in view is likely to come about, so that one may be thoroughly prepared for the change when the time comes. All this is obvious enough with regard to matters of commerce, of labour conditions, of market prices, and the like; but the same view, it is thought, applies equally to all forms of business organisation. In every branch of this subject that may be

considered from time to time, certain opportunities will occur. The man who is ready for these opportunities will be in a position to profit by them; but if he is not ready, they will in all probability pass him by, and will not recur. They will become purely wasted opportunities. But, in another sense, business life is made up of events for the most part similar to events that have taken place in the past; so that, with a certain amount of knowledge of the past, and a certain amount of ability in using that knowledge, it is possible to take advantage of at least some of these fleeting opportunities —and that probably is as much as any one can expect to do. In the same way that no business can be conducted without some outlay, so, it is submitted, can no business be conducted without some opportunities being missed; without some expenses being incurred, and some losses sustained, that might have been avoided; without some failure to secure the benefit of opportunities that might have been secured. All that one can hope for in business is, not to avoid all mistakes, but to secure a somewhat lower percentage of errors of calculation than one's competitors.

The present handbook puts forward no claim to be regarded as a guide to success in business; but it is hoped that it will be found suggestive, as indicating the lines upon which further enquiry may be pursued with advantage. For the reason that it makes some slight attempt to be practical, it is of necessity inconventional, regarded from the point of view of the ordinary text-book; but should it, in ever so slight a degree, have

the effect of suggesting to the scholar, or to the practical business man, that they might each have something to teach the other, if only they would be content to speak the same language, it is thought that this departure from precedent will be abundantly justified.

LAWRENCE R. DICKSEE.

48, Copthall Avenue, London, E.C.,
19*th April*, 1910.

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BUSINESS ORGANISATION

CHAPTER I

THE NATURE AND CONSTITUTION OF BUSINESS HOUSES—PARTNERSHIPS—BORROWED CAPITAL

IT is proposed, first of all, to consider the question of the constitution of business houses: how they should be formed; how, and for what reasons, we should make a choice between the various possible forms; and, generally, what are the underlying causes for these varieties. We must necessarily, of course, deal with the matter in quite general terms, and not as applied to any particular class of business; but the term "business" of itself fairly suggests a form of activity limited in at least one direction, namely, that it is a form of activity pursued primarily with the object of earning profit for the benefit of those on whose behalf the business is conducted. There are, of course, various other kinds of activity, but those we can leave out of account as not properly coming under the heading of "business organisation."

The Importance of Permanent Efficiency.—Now, if we

confine ourselves to concerns that are run for profit, we confine ourselves to concerns in connection with which the real justification for their existence is financial success. And in the great majority of cases financial success means not merely a satisfactory profit made at the moment—a kind of "flash in the pan"—but a satisfactory profit made throughout an extended number of years; for it is quite exceptional for a business to be founded, save with the idea of continuing it for a considerable number of years, if not almost indefinitely. At a later stage we shall have to consider the exceptional class of business house which from the outset is known to have only a limited life—what we may call a form of temporary business—in connection with which we may apply some special rules and conditions; but for ordinary purposes business houses should be so constituted that they will be successful, not only at the moment, but also permanently.

The Requisites for Success.—Now, for that purpose three distinct requisites are needed. It would be difficult to place them in any order, because the order of importance will doubtless vary according to circumstances; but, in a greater or smaller degree, it is necessary that those who represent the guiding spirits of any business house should, among them, be possessed of the necessary skill and energy to enable them properly to carry through what they undertake, and the necessary capital to tide them over the period that must necessarily elapse in most cases before they actually receive a return for their labours; and, further, they must be possessed of—or have the means of speedily acquiring—what, for want of a better word, may be called "connection," or reputation,

It is of very little use being able to transact business, if we cannot in one way or another provide that there will be people coming to us who are willing to do business with us, so that this question of connection is certainly one that we cannot afford to leave out of account. If we are possessed of skill and capital the connection will doubtless follow in due course, if we can afford to wait for it; but it may be a very lengthy process, and therefore if we have no connection we shall certainly require a relatively much larger amount of capital than would be necessary if we had the connection. So we may fairly say that connection, as well as skill and capital, is a requisite on the part of the proprietary of any business house.

The Need for Combination.—Now, although we have only enumerated three qualities, a great deal is implied by these three terms; and if more than a very ordinary quantity of each is required, it is more than likely that we shall not be able to find the requisite quantity of each embodied in any one individual. Therefore, save in connection with comparatively small concerns, we usually find that a business house cannot be run successfully single-handed. In order that the proprietary may among them be possessed of the three requisites that we want for success, we have frequently to combine forces, so that the qualities possessed by several individuals may be made collectively available for the common purpose. A man with skill and connection, but without capital, is, as a rule, very greatly handicapped in consequence, although he may to some extent perhaps succeed in doing without a large capital by the aid of the next best thing—credit. If those with whom he has business relations are very

confident of his skill and of his ability eventually to succeed, they will doubtless be willing to deal with him upon less onerous financial terms than if they were less sure of his ability; but we may be pretty sure that, even then, they will exact a price for their consideration. It thus becomes a question of calculation—a question of figures—whether it is cheaper, and generally more advantageous, to borrow money from one's business connections (for that is what it really amounts to); or to borrow money from a single creditor, to be used as Capital; or to join forces with capitalists and give them an interest, or share, in the undertaking. In one way or another we must get the capital into the concern, if it is to stand any reasonable chance of success.

But, of course, it is not always for the sake of additional capital that we find persons working in combination as a business house, instead of each individual working upon his own. A combination under which one party has the skill and the other party has the connection is very common, and often a very advantageous one; and we generally find in any combination that the preponderating skill is with some of the parties, and the preponderating amount of connection, or of capital, with others. Here, as everywhere else in the world, we rarely find anything approaching an absolute equality at the start, or for that matter at any other time.

Partnership.—The simplest form of combination—and it will be convenient to take the simplest first—is a Partnership. That is to say, a combining together of two or more individuals agreeing to carry on a business jointly for their mutual advantage. We will assume, in the first instance, that each partner takes an active share

in the business; the qualities that we look for in partners are such that, among them, we may have a satisfactory combination of the requisites already named: skill (in connection with which we ought, perhaps, to add energy), connection, and capital. It is by no means essential that each partner should be possessed of all these qualities, but it is essential that, among them, they should be possessed of a sufficient quantity of each to go round in a satisfactory way.

Reliance on Employees.—Alternatively, of course, in some cases the qualities in which the proprietor, or proprietors, are deficient may be supplied by employees. That is a possible alternative, but generally it is not so entirely satisfactory, because then the combination is very much more unstable. We may leave out of account the employee whose sole qualification for his employment is the possession of capital. It is a quite unusual condition of affairs, and we may take it that in almost all cases it is unsatisfactory—meaning, as it generally does, that a relatively high rate of interest has to be paid for the use of capital, coupled with inefficient services. The man who is possessed of capital and either connection, or skill and energy, can in the majority of cases do better for himself than obtain a salaried position together with interest on money lent. It is an arrangement that is likely to prove only temporarily successful. As a preliminary step towards a partnership upon a more permanent basis—as a means of taking a partner, so to speak, on trial—it may work very well for a time; but if the arrangement is satisfactory from the point of view of the business house, we may be sure that the employee will not be

content with such a situation for long; therefore it cannot be regarded as a permanent solution of the difficulty. Persons possessed of connection may be, and sometimes are, mere employees. That is a state of affairs that one finds much more frequently in connection with persons possessed of connection than with capitalists. For instance, all the business houses employing commercial travellers are employing men who, up to a point, may be said to commend their services to their employers chiefly by reason of the fact that, by the aid of the personal connection of each of these travellers, the firm is able to extend the market for its goods. The position is one that may prove quite satisfactory; but on the other hand, like every other combination, we must be very careful to see that it does not get top-heavy. If the bulk of the connection of a business house were the personal connection of its employees, that house would be at the mercy of its employees practically every hour of its existence. At any time they—or an appreciable number of them—might leave it at short notice, and perhaps set up in competition.

Restrictive Agreements.—This question of competition may, of course, be avoided: the risk may be eliminated by entering into an express agreement with each employee, restraining him from setting up in business, or joining any other business house carrying on a similar business, within a specified distance; but it is probably questionable whether an employee with a personal connection would submit to such terms at all, and in any event it is doubtful whether any such conditions as are capable of being legally enforced would serve any very useful purpose, as protecting the employer. In general

terms the law regards it as against public policy to place restrictions in the way of any one earning his living in any legal way; and therefore an agreement which, in effect, would prevent a man from earning his living in the way in which he has hitherto been accustomed to earn it is generally absolutely void. It is only legally enforceable when one does not attempt to do what one would really like to do in an efficient way, but is content with a limited application of it—upon the principle that "half a loaf is better than no bread." An agreement that a man shall not enter into the employment of any one else is an example of the unenforceable agreement. An agreement that he shall not do so for a limited time, within a limited distance from the business house of his late employers, would usually be enforceable; but in the nature of things, of course, it only partially protects the business house against the danger mentioned. If the connection of the business house is to an appreciable extent the personal connection of the employees, we get a top-heavy relationship—a state of what mechanicians would call "unstable equilibrium"—which may answer all very well for a time, but is not likely to last as long as we would wish. But within limits there is certainly scope for increasing the connection of a business house by taking on employees, just as much as by assuming partners.

With regard to skill and energy, here to a very large extent, of course, it depends upon the precise nature of the business how far it would be safe to depend on employees for these most important commodities. As reinforcing the strength of the proprietary, skilled employees are unquestionably advantageous; but if all

the skill is to be in the hands of employees, we have again a state of unstable equilibrium—a state which does not make for permanent success. And of course the more a very high order of skill is an essential for the success of the business we have in hand, the more undesirable is it that such skill should rest solely, or even substantially, in the hands of employees. It is for that reason, doubtless, that, in connection with those occupations where skill of a very high order is absolutely essential, one frequently finds in practice that persons possessed of the necessary qualities are placed in the position of partners by the joint proprietors, even although they are able to bring little or nothing into the business in the way of either capital or connection.

The Law as to Partnerships.—Partners may be of various kinds; but under the law of England, in the absence of any agreement to the contrary, the law assumes an equality between partners as regards their shares in the profits of the business as a whole, and as regards their voice in the management of the business. But for certain fundamental purposes the approval of all partners is necessary. For instance, a new partner cannot be taken on without the consent of all the existing partners, nor for that matter can any fundamental change be made in the constitution of the firm without the consent of all; but so far as ordinary everyday working is concerned, the assumption of the law is that all partners are entitled to an equal voice, and that unless the matter in dispute is absolutely vital it is to be decided by a majority of partners. The law, however, does not go so far as to assume an equality of wealth on the part of the partners. There is no

communism about a partnership. Each partner brings in such amount of wealth, or capital, as may have been arranged at the commencement of the partnership, and the partnership is responsible to him for that amount, and will have to refund it to him at the expiration of the partnership, subject to the provision that, if there have been losses, and therefore the capital is not intact, such losses must be borne by the partners in equal shares, so that each partner's share of the loss may be deducted from his capital when it comes to a final settling up.

Requisites of a Successful Partnership.—It is as well to bear in mind this theory of equality, because it underlies a good deal of the partnership law; but it is perhaps hardly necessary to add that, as a matter of business practice, what may be called equal partnerships are quite unusual. They would no doubt represent a very fair arrangement, making for permanency, if each partner were possessed of equal skill, of equal following or connection, and if each brought in an equal amount of capital. Even then it would seem necessary to provide that each devoted an equal amount of time to the business, before we could agree that they should share profits equally. But we very rarely get anything approaching equality in all these directions, and therefore in the majority of cases there could not in fairness be equality. We have, therefore, different factors to consider, probable differences of ratio in connection with each, and it becomes a matter of arrangement between the partners as to how these different quantities of each of the three qualities that we regard as essential shall be summed up, and expressed in an appropriate fraction of

the whole profits. Then, again, one has to remember that these three qualities, apart from the fact that they are rarely enjoyed by all persons in equal ratio, are by no means equally rare—or equally common, whichever way it is preferred to put it. The skill necessary to conduct some businesses is comparatively small, and may perhaps be acquired in a short space of time by any person of ordinary intelligence and tact. In other businesses the requisite skill can only be developed after a very long and expensive training, which perhaps continues during the whole of a man's lifetime. On the other hand, there is not, as a rule, much difficulty in finding people with money who are willing to invest it in any concern which promises a good return in the way of profit. A good connection is perhaps, in the majority of cases, the most difficult of the three to acquire. It will be seen, therefore, that what may be called the competing claims of a partner who is possessed of the majority of the skill or the majority of the connection, as against the partner who has the majority of the capital, are all against the latter. It would be easier to replace him than the former, and he could doubtless be replaced with less disturbance to the stability of the business itself; but here again, of course, the question of capital cannot be very well considered in the abstract, or in general terms. What we may call the power of the capitalist-proprietor will vary materially according to circumstances. In some businesses the amount of capital required is quite small in proportion to the annual profits. It might even be considerably less than the annual profits in some cases, and then the necessary amount of capital can be obtained practically anywhere, so long as the profits

are assured. Some businesses, on the other hand, require for their successful conduct extremely large amounts of capital, representing perhaps even more than ten times the profits of a year. In such a case we have what we may call a "corner" in capital. The business cannot be conducted unless we can induce the capitalist to come in. The position is the other way round. We have to make a tempting offer to the capitalists in order to induce them to consider our business as a suitable investment for capital. In those cases naturally the capitalist will expect, and in practice will be able to obtain, a better return than if he is connected with a business where only a small amount of capital is required in relation to profits. That is only fair, not merely according to the economic law of supply and demand, but also because the risks run by capitalists in those cases are substantially greater, and therefore the return must be greater in proportion.

But apart from the competing claims of skill, connection, and capital, for shares in the profits of the business, there is a further factor that must not be left out of account, although it is perhaps chiefly in the nature of skill. Skill is of very little use to us unless it is applied for our benefit, so that what we may call the energy of the partner—the amount of time and thought that he is willing to place at the disposal of the business—may be raised almost to the dignity of a fourth factor in our equation. In the majority of partnerships it is no doubt usual to provide that each partner shall devote the whole amount of his time to the business. That means not so much that he is obliged to be thinking of the business every hour of the twenty-four,

as that he must not devote any part of his time and energies to making profits in connection with any other business. He would be free, of course, to invest his surplus capital, and to devote so much time as might be necessary to the husbanding of his investments ; but he would not be free to associate himself as proprietor, or part-proprietor, with any other business, competing or otherwise. If he wished to do that, there would have to be an express agreement to that effect ; and although such arrangements are sometimes made, they represent one of those rather dangerous provisions that are very apt to lead to ultimate dissatisfaction.

Importance of Solidarity.—An ideal partnership will certainly be one that will extend over a considerable period of time, during which each partner will work for the common good without giving a second thought to his own personal interest, as opposed to the personal interests of his co-partners. If that state be not achieved it stands to reason that an appreciable amount of the time and energy of each partner is devoted, not to the common good, but to the distinct disadvantage of his co-partners. There is no sort of middle course. If a man is not working for his co-partners, he is working against them : and directly that state of affairs is brought about, the result must be unsatisfactory, not merely to the other partners, but to the whole organism. Incidentally it is a frame of mind that is very catching. If A finds that B is looking after "No. 1," as a rule it does not take him long to follow suit ; and then clearly it is a question of each for himself, and what we may call the central organisation—the co-partnership—comes in a very bad last. In general terms it may be said that

the only form of partnership arrangement that is likely to be permanently satisfactory is one that each partner continues to regard as advantageous to himself. Individual partners may cheerfully do more than what they know is ordinarily their share of the work for a time (particularly if there is any special and obvious need for it; as, for instance, during the illness of a co-partner); but, human nature being what it is, the time will probably come when they get tired of that; and therefore, viewed broadly, and from the point of view of permanency of success, an arrangement which is unacceptable to one may safely be regarded as dangerous to all.

Rights of Partners.—For a variety of reasons it is not always equitable, let alone desirable, that each partner should be given an equal share in the management or control of the undertaking. It is clear that the paramount control should be given to those possessed of the most skill, including, of course, business experience. On the other hand, the claims of those possessing the connection must not be overlooked; and, yet again, we must not altogether crowd out the mere capitalist. He may know little or nothing about the business, but he is at least entitled to some sort of a voice in the way that his money is applied for the benefit of the business. So that here again are to be found—and one in practice frequently does find—variations of the legal theory of equality. We find working partners who have only a limited amount of control (if any control at all) in the general, or financial, policy of the business (or perhaps both); and we find again "sleeping" partners, who take no part whatever in the working of the business, but may perhaps be possessed of some kind of financial control.

Limited Partnerships.—Prior to the passing of the Limited Partnerships Act, 1907, the position of a sleeping partner was a matter of contract between the partners, and as between himself and the outside world the sleeping partner had the liabilities of a full partner, that is to say, the whole of his fortune might be endangered by the failure of the business. The Limited Partnerships Act brought into use in this country a form of business organisation which for many years past has been used in France and Germany, in which it is possible for a man to have capital invested in a business without incurring any liability to bring more money in in the event of disaster, and yet to take any share of the profits that may have been mutually agreed. The Limited Partnerships Act has been framed, doubtless, with the express object of not allowing the paramount partner to escape financial responsibility by putting forward men of little or no means as the only active partners who incur unlimited liability. The limited partner must take no part whatever in the management of the business. He may advise, but he cannot control; and his position is rendered the more ineffectual, from his point of view, by reason of the fact that, if he dislikes the way the business is being carried on by the active partners, he has really very little scope for redress. Matters have got to be very serious before he would have the right to terminate the arrangement. Before he could do so, the probability is that the active partners—assuming them to be unscrupulous or quite incompetent—might have lost the whole of his investment for him. As a mode of investment for capital the limited partnership is therefore, perhaps, not very likely to become general;

but it may prove convenient where a senior partner is desirious of retiring, and, trusting his co-partners, is quite willing to leave with them the whole (or a portion) of his capital upon terms. In such a case there is nothing to prevent him from entering into a limited partnership with them, receiving in exchange for his money such a share of the profits as may be arranged ; but there is little likelihood of the limited partnership achieving the popularity in this country that it possesses on the Continent. The reason is that, on the Continent banks—or financial houses that call themselves banks—are quite willing to advance money to business men on limited partnership arrangements ; that is to say, permanently to lock up money in commercial businesses in exchange for a share of profits. That is a form of investment which is certainly not regarded as legitimate banking business in this country, and the Limited Partnership Act is not at all likely to induce British bankers to undertake it. But a limited number of private investors may find it advantageous, and retiring partners will probably find it a convenience ; or it may even suit the executors of deceased partners in certain instances. But it is an arrangement that, upon the face of it, is much more advantageous to the borrower than to the lender, and therefore, save in times when there is a difficulty of finding an output for capital, the chances of limited partnerships becoming at all general do not appear to be great. The provisions were such that, unless the limited partner feels very confident of the ability and prudence of the managing partners, he may well hesitate before putting money in a concern over which he has absolutely no control, and from which it

is impossible for him to withdraw his money within the prescribed period of time. But, provided the necessary confidence exists, a limited partnership has this advantage over a mere loan of capital at a fixed rate of interest, that, in concerns where there is an appreciable risk of loss, it will be possible for the investor to participate equitably in the profits, should there be profits.

The Theory of Interest.—The whole theory of interest on money is, of course, that the interest is a payment, or reward, for services rendered, which services are of advantage to the borrower. We may take it, that a man in possession of money is a man who, in some way, has acquired the right to call upon others to render him services, or to supply him with goods, whenever he chooses. The possession of money implies that right, and of course also the right to postpone the demand until a more convenient time. The essence of a monetary system is that a man, having himself expended effort, and being therefore entitled to call upon others for corresponding efforts or sacrifices, may, instead of demanding that return forthwith, postpone it until a future date. The right exists, but the right may be said to be latent until the money is again applied. By lending money the capitalist may be said to transfer the right to the borrower, in exchange for an agreement that at some future date he shall again be placed in possession of the right. If that involved no sacrifice whatever upon the lender's part, and no risk that he would not eventually receive back the right, in time to make such use of it as he might wish, it would be difficult to justify anything in the nature of a charge for interest. But there must always be a certain element of risk in the matter. The

risk may be that the capitalist does not quite know when he will himself wish to exercise the right that the possession of the money vests in him. He may therefore require some compensation against possible loss, in the event of his being inconvenienced because he has transferred that right in the meantime to some one else; but the chief factor in connection with interest is undoubtedly the factor that it is impossible to allow some other party the use of one's money for a time, without incurring some risk that one may altogether lose the right of enjoyment to which the possession of that money entitles one. So long as the risk is not serious, it may easily be expressed in the form of a comparatively low percentage, and the exact amount of that percentage will depend partly upon the risk, but perhaps more upon the possibility of inconvenience to the lender if he wants the use of his money before he can recover it from his borrower. If he wants the use of his money before he can recover it from the borrower, he in his turn has to borrow somewhere else; or to transfer his rights to some one else, who naturally will require some payment for the services thus rendered. Any rate of percentage —say up to the ordinary Bank Rate, or even a little above the ordinary Bank Rate—may probably be regarded as this charge for recompense to the lender against possible loss and inconvenience, and as not taking into account (or at all events, not seriously taking into account), the risk of ultimate loss of the capital lent. But directly money is employed in ordinary business undertakings, it will, of course, be idle to suppose that there is no risk of loss. Practically no business can be done without running some risk of loss—not necessarily of the whole of the

capital advanced in the entire business, but the risk of loss of some portion. The extent of that risk of loss in connection with the business as a whole, and the proportions of borrowed capital to the capital of the proprietors themselves, will determine the actual risk run by those who lend money to a business as capital—and if the proportion of borrowed capital is at all considerable, the risk undoubtedly becomes one that can no longer be left out of account. In that way we find an explanation of the relatively high rates of interest that are sometimes charged when there is nothing in the general financial situation to demand high rates. The excess may be regarded as an insurance premium against loss of capital. But if the bargain between borrower and lender is one for the payment of a fixed high rate of interest—as it will be where the risk is appreciable—we very soon reach the limit when prudent borrowers would be deterred from borrowing at all on account of the serious consequences to themselves, if their ventures prove less profitable than they expected, or even if the time were unduly delayed before their profits mature. Directly we get anything approaching a high rate — anything (at all events in this country) over, say, five per cent.—we have to consider what would be the effect if this interest were an absolute drain upon the resources of the business, and the money borrowed could not be used so advantageously as to produce the profits required to pay the interest as it becomes due. Whence it follows that, if capital has to be borrowed in anything approaching relatively large quantities, the rate of interest naturally rises in sympathy as the risk of losses increases, and soon becomes prohibitive.

Practical Arrangements.—This naturally paves the way for an arrangement between borrower and lender upon a sliding scale, under which the lender is paid either wholly or partially by results. To a certain extent the lender thus becomes financially interested in the business, like its proprietors; and for that reason the tendency of the law of this country, until recently, has been to discourage such an arrangement by making the lender fully liable as a partner. Doubtless this was because it distrusted the *bona fides* of such arrangements, and was disposed to conclude that the lender in such cases would probably be a full partner, if not the chief partner; and that the managing partners put forward as the actual partners might only be men of straw, and agents of the capitalist, who thus sought to embark upon speculative undertakings with limited liability. However that may be, arrangements upon a sliding scale are now (under the Limited Partnerships Act) much more practicable than they were in the past, without going through the formality of registering a regular company; and although limited partnerships are hardly likely to become a very usual form of the constitution for business houses, it has been thought just as well to deal with this question of the return that the capitalist is reasonably entitled to for his money, because to a large extent the same problem obtains with all the more complex forms of business house, where the majority of the capital is usually provided by persons who take no part whatever in the management.

CHAPTER II

THE NATURE AND CONSTITUTION OF BUSINESS HOUSES (continued)—LIMITED COMPANIES —PUBLIC AND PRIVATE COMPANIES—CO-OPERATIVE SOCIETIES—SECRET ORGANISATIONS.

Private Companies.—Now, passing on to the question of limited companies, these may be divided into two classes —private companies and public companies. Private companies were first recognised by the Legislature in the Companies Act of 1907, which came into force on the 1st of July, 1908, but for a great number of years past they have been recognised among business men, although their legal position did not differ—or did not differ materially—from that of public companies. The chief differences between a private and a public company now are, first, that a private company may be registered by two applicants instead of seven. As the applicants for the registration of a company (or the signatories to its Memorandum of Association, as they are called) are almost invariably nominees, there is perhaps not much in the reduction of the number from seven to two. The intention doubtless was to discourage the employment of nominees, in the hope that *bonâ fide* members of the

company would sign its Memorandum of Association; but whether that is likely to be achieved is, perhaps, a more open question. The second distinctive feature is that the private company must not make any application to the public for subscriptions for its capital. It must find its capital without making any invitation to the public to subscribe, and in particular must not issue a prospectus —which is, of course, the most obvious form of invitation. Thirdly, a private company must, by its regulations, limit its membership to fifty, but persons in the employ of the company need not be reckoned in counting the number of members for this purpose. How that would work out if a considerable proportion of the company's employees were to leave it, and thus become no longer employees, remains to be seen. It is not impossible that there might be considerable difficulties in store for that company in practice, which might require the wording of the Act to be amended. And lastly, private companies are distinguished from public companies by not being required to file with the Registrar of Joint Stock Companies any statement in the form of a Balance Sheet. Since the Companies Act of 1907 came into force, public companies have been required to file such a statement at least once a year, which must have been duly audited by the company's auditors; but as the statement need not even be a copy of the balance sheet submitted to the shareholders, but may be in the most condensed form possible, provided only that it states the principle upon which the Fixed Assets of the company—that is to say, its general equipment—have been valued, this statement is not really any very effective disclosure of the financial position that is likely to prove

of much practical assistance to creditors, or for that matter of much inconvenience even to private companies. But still, for what it is worth, private companies have thus been legally distinguished from public companies, and where there is no intention of asking outsiders to contribute capital, it is very likely that a considerable number of private companies will be registered from time to time for the sake of carrying on existing businesses which are either getting too large to be conveniently managed by a partnership, or in cases where senior partners are contemplating retiring, or have died, and it is convenient to make some more elastic arrangements on the subject of capital and the valuation of goodwill.

Companies and Partnerships Compared.—As a rule, doubtless the former partners of the partnership will continue to be directors, and the sole directors, of the private company, and for all practical purposes it will be managed in very much the same way as before; but the private company possesses all the practical advantages of the public company of enabling capital to be adventured in business upon very elastic terms. Precisely what those terms are may be considered in connection with both private and public companies together. It will be convenient to do so in greater detail when the question of financing a new business is dealt with in Chapter III., but at the present moment it may be pointed out that the essential distinction between a company and a partnership is, that the existence of the company goes on irrespective of the lives, or the inclinations, of its members. If a member of a partnership dies, the partnership is dissolved, and the partnership

property has to be sold—even if it be only sold to the surviving partners—and the cost and delay necessitated by the formal conveyance of assets that must be conveyed by deed must be incurred every time there is a change of partnership. In the case of a company, the company being once possessed of its assets, no further costs of conveyance are necessary during its lifetime, unless the company itself has occasion to sell them. Then, again, if a partner in a business wishes to draw out his capital, or a portion of his capital, he can only do so with the consent of all the other partners, which puts them in a position to impose terms ; or they may even refuse altogether. In the case of a company, any member has a right to sell his holding to any one he likes, or he may sell any portion of his holding ; so that here he will retain his investment in a "liquid" form, instead of it being a more or less permanent "lock-up." In the case of public companies such shares may usually be dealt with freely on the London and provincial Stock Exchanges. A person desirous of selling his holding, or a portion of his holding, will not necessarily secure a return of what he originally invested, but he can at all events sell with very little delay at whatever price his holding is regarded in the open market as then being worth, which may be more or less than it cost him. He is at least free to deal in the open market, and is not compelled to make terms with his co-partners or else do without his money altogether. He has thus every reasonable chance of making a fair bargain.

Transfer of Holdings.—This right of disposal of shares may, however, be restricted, and, indeed, a private company is required by law to place some restriction

on the transfer of its shares. The restriction may be purely nominal, as, for instance, that the directors reserve the right to approve the proposed transferee; or it may, on the other hand, be so extreme as to make an investment in a private company as difficult to dispose of as an investment in a private partnership. There may even be a provision that any one desirous of selling shares must first offer them to the directors at their face value, or there may even be the provision that they must first be offered to the directors at "a fair price," to be determined by the directors themselves, which is about as extreme a case as one might well get. Whether that particularly extreme form would really hold good in a court of law, it would be difficult to say; but short of that it may be taken that a private company may be so constituted that it is practically as difficult for any member to sell his shares as it would be for him to dispose of his share in a private partnership. But even then, of course, he has this advantage over a partner, that whatever happens, he cannot lose more than the amount that he has agreed to subscribe.

Public and Private Companies Compared.—As a matter of ordinary business practice, it would seem that the line between public and private companies is really drawn in quite the wrong place. There are a great number of companies with comparatively small capitals—capitals which certainly ought to be within the means of three or four members—virtually managed by one man alone, which yet rank as public companies and have official quotations on the Stock Exchange. Investments in such concerns as these can hardly be said to be upon the

same footing as investments in what, for the sake of contrast, may be called *bonâ fide* companies. They really represent a means by which one individual—or at the most two or three individuals—is enabled to borrow money to use as capital practically on his own terms, without ever being liable to repay it, for of course the shareholder can never ask the company for his money back. The shareholder can never even ask the company for interest on his money, and therefore he is in a very much more unsatisfactory position than a creditor, or a lender of money, in the event of things proving unsatisfactory. He is, for all practical purposes, lending on the personal security of the one man, who under the most favourable circumstances will at all events die some day, leaving the future prospects of the company in a very different state to that in which they stood when the company was formed. The conditions laid down by the London Stock Exchange as a condition precedent before it will grant an official quotation for shares represent roughly the *minimum* conditions representing suitable terms for the investment of the general public. They stipulate for a minimum issue of about £30,000, which is certainly not excessive, and a provision that at least two-thirds of that capital shall be *bonâ fide* offered to and taken up by the public. The importance of that comes in, of course, in that it means the moving parties in the business, holding as they must only a minority of shares, cannot exercise any voting power, or acquire any serious control over the company, unless they can attach to their side a substantial portion of the investing public. Of course it is common knowledge that even these conditions do not by any means suffice to protect the investing public

against loss in connection with company enterprise, but at least it may be said that the public stands a better chance of not losing if it limits its investments in the "quoted" companies, than if, with the object of securing a slightly higher return, it invests in small and unquoted companies. The risk of ultimate loss is less, and the investment is in the meantime in a far more liquid form, and therefore one upon which the public ought in fairness to be content with a smaller return.

Co-operation.—This subject of limited companies will, of course, have to be referred to again and again for various purposes; it may therefore now be left for the moment, and attention directed to another form of constitution for business houses, which, although it is still unusual, is by no means without importance in the commerce of this country, namely Co-operation. Co-operation is found chiefly in two distinct classes of activity. In the insurance world a certain number of so-called "mutual" societies are to be found, which are really in the nature of business houses run by the customers of those houses, not so much with the object of making a big profit out of the insurance, as to supply themselves with the services that they require in a satisfactory form, and at reasonable rates. In addition to the mutual life offices, that practically every one knows about, there are in connection with many trades mutual assurance associations against some particular contingency to which that trade or occupation is especially liable. They represent, doubtless, risks not very well understood by ordinary and general insurance houses, which therefore these general houses were not prepared to undertake, save at somewhat prohibitive rates;

therefore those who desire to be insured against them have combined among themselves and built up mutual assurance associations. The more familiar form of co-operation, however, is in connection with co-operative societies and friendly societies, which among them may be said to embark upon practically almost every conceivable kind of occupation, but especially, of course, that of retail traders. Building societies, upon the same lines, may be said to be mutual associations, by the aid of which those willing to invest their money upon the security of mortgages of houses and shop property are brought into direct contact with those who may wish to borrow money upon such securities without the intervention of banks. Indeed, regarded as business houses, the existence of all forms of co-operative society seems primarily to be due to the absence of reasonable facilities in the particular direction that was desired—either the prices charged by companies or by insurance companies or by banks were regarded as prohibitive, or the object was to supply something required at a lower price than that at which it was formerly obtainable, rather than to embark actively in commerce for the purposes of gain. As a result a co-operative society may be regarded as in the highest degree successful without necessarily showing any profit. Its profits are not the measure of its success in the same way that they are the measure of the success of an ordinary business house, and in that sense perhaps co-operative societies can hardly be regarded as business houses at all. But there is this point to be borne in mind in connection with them, although they are perhaps outside the scope of this work altogether—that, one and all, they represent

the possibilities of financial weakness in the absence of the possession of a sufficiency of capital *permanently* devoted to the purposes of the undertaking. The capital of a co-operative society is usually made up partly of deposits of customers and others, withdrawable at comparatively short notice, and partly of shares, similarly withdrawable. The shares of a limited company are not withdrawable. If the investor wishes to realise, he cannot obtain his money back in any shape or form from the company itself, nor can he at all times obtain repayment of the amount of deposits that he has put in on debentures. He must realise by finding some one who is willing to step into his shoes. In the case of a co-operative society or building society, however, a member who wishes to withdraw has, subject to the rules of the concern, the right to ask for his money back. Those rules may give the undertaking time in which to pay. They may stipulate for a certain amount of sacrifice on the part of the withdrawing member by making him liable to fines, or to forfeiture of profits; but sooner or later the liability to pay out the amount of capital originally put in matures as a debt due to the withdrawing member, and if the restrictions imposed upon withdrawal are sufficiently effective to safeguard the undertaking financially, they will probably be regarded as vexatious, and materially interfere with the popularity of the concern itself. So these undertakings, although doubtless the great majority of them do a very useful work, are liable to be in a state of financial instability in times of emergency. If there is some financial disaster in the locality—as the result, say, of a colliery accident, or a strike—there will be wholesale

notices for withdrawal. If there is news, or even a rumour, of serious deficiencies on the part of an official, a great number of timid shareholders will at once be clamouring for their money; and whatever the precise nature of the business may be, so far as this money is really required for the purposes of that business, and is therefore really producing the wherewithal to pay the interest or profits on the capital, it will continue to be required *à fortiori* at those very times when demands for withdrawal will be greatest. Of course this is not put forward as a definite argument against the existence of these societies, but simply as a point in which they are undoubtedly at a disadvantage with the more usual forms of business houses—a disadvantage which they will naturally not feel when everything is going well, but which may very seriously prejudice them in times of stress.

Working Arrangements.—There still remain to be considered what may be called "complex" constitutions. Hitherto attention has been directed to the precise form in which the co-adventurers in a business undertaking may constitute themselves as the proprietors of that business; but if the business is not of the simplest it does not necessarily follow that it will suit their ends to be known in one form alone. They may find that they can work better in two or more different aspects, that is to say, under two or more different names. They may split up their functions so that certain functions are discharged by a concern under one name, and certain other functions in another name. Perhaps the commonest example of that is where the manufacturer or wholesale trader, not being content to deal only with what, for the sake of clearness, may be called his legitimate

customers, opens also in business as a retailer upon his own account. If he opened as a retailer on his own account in his own name, he would probably find his transactions with legitimate customers considerably reduced; but if he trades in another name, so long as these customers remain ignorant of the connection, he is in a position to make the best of both worlds, and of course to get the profits of both.

Secret Trading.—Another form is to open a subsidiary branch under a different name, with the object of dividing what we may call a local trade. Thus, for instance, German or American houses may find that they can get a better output for their goods in this country, if they trade here in a British name. If they can, it is reasonably certain that they will do so. Such cases are by no means uncommon, and as a rule they are carried out in their entirety, and not merely on the face of things. That is to say, a separate company is probably formed to work that particular branch, with local directors and so on, in the usual way; but the majority of the capital, or perhaps all the capital, is held by nominees of the foreign business house. Or, of course, the process may be reversed, and British business houses may in the same way operate in foreign countries. As a rule, however, it is more difficult to work it that way round, because most countries are very much more particular with regard to the registration of business houses than Great Britain.

Then, again, we may have what we may call "alliances" of business houses. Business houses may, without amalgamation, enter into some form of working arrangement, upon terms; but the form of the working

arrangement may vary almost indefinitely. Thus two houses doing a large export trade might divide the map of the world between them, upon the understanding that neither of them should compete in the other's districts. There might be an arrangement under which one business house undertakes to purchase a certain quantity of the other's output at an agreed price. There might be cases in which each house agrees to pay over to the other a specified fraction of its net profits—thus making each in a sense a partner of the other house, to such an extent, at all events, as to ensure their not trying mutually to cut each other's throats. The advantage of such an alliance as the last named, may be because the two parties may then possibly be able to undertake work which would not otherwise be possible. It may be, for instance, that, with regard to certain contracts with public authorities, there is a maximum amount that may be given to any one business house; or it may be that a certain amount must, under the usual practice, be given locally. There may be all sorts of reasons suggesting the advisability of such an arrangement. Where the arrangement is in substance one to refrain from what we may call "cut-throat" competition, it is probable that its benefits are not restricted to the two particular parties; that the benefit is general, as reducing the expenses of both business houses, and thus reducing the cost of production generally, to the mutual benefit. But where, as is sometimes the case, the alliance is with the object of removing the competition without the fact being made apparent, the effect, of course—and the desired effect—is to force up prices, and thus increase the profits, and then the benefit to the consumer is by no means so obvious.

CHAPTER III

THE FINANCING OF A NEW BUSINESS

It is now proposed to discuss some of the problems affecting the financing of a new business. In many cases, of course, a business expands gradually from a comparatively small into a quite large undertaking, and in those cases these problems of financing have to be met not all at once at the outset, but gradually and more or less continuously; but if the principles involved in connection with the financing of an entirely new undertaking are clearly grasped, the reader is not likely to experience any serious difficulty in applying them piecemeal to an expanding concern.

The Importance of Careful Estimates.—When arrangements are being made to embark upon an entirely new business, it stands to reason that the promoters must, in the first instance, form a very clear idea as to the nature of the business they propose to undertake, and they must frame very careful estimates of what they may expect to do, at all events for some little time ahead. In a sense, of course, no new business is ever called into existence all at once. Even a new business to some extent exhibits a process of gradual expansion; but before the promoters have undertaken the venture at all, they have presumably gone into the matter sufficiently

to consider the volume of business they are likely to be able to transact, the minimum amount of business that they can work with at a profit, and what arrangements they must make in the way of equipment, to enable them to cope with any amount of business in reason that is likely to present itself. All this applies whatever the nature of the business may be. In the case of a purely trading concern, when the promoters look forward to a stated volume of trade, or turnover, as the minimum, and estimate, so far as they can, the probable maximum demand in the first instance. In the case of a manufacturing concern, they consider the output that they are likely to be able to dispose of, and the means by which they propose to create it. In the case of a public service concern, such as a railway, they consider the probable traffic that they will have to cope with, and what facilities they must provide to enable them to do so satisfactorily. In each case they have to form an estimate of a demand, and if their estimate is excessive they can, as a rule, hardly hope to produce financially good results until that minimum has been reached. But equally important is it, from the point of view of practical finance, to consider the question of the probable maximum. If they have so miscalculated that the demand upon the commodity, or services, which they are in a position to supply is greatly in excess of their expectations, they will be hopelessly unfitted to supply them with satisfaction to those that they look to for support; and in that way they may seriously damage the reputation of their business at the outset, instead of building up a valuable Goodwill as they had hoped to do. A reputation for unreliability in the matter of delivery of goods, or for inadequate

services, is one of the things that at all effort they must do their best to avoid, if possible. Hence the importance of reliable estimates, not merely of a minimum but also of a maximum demand.

Capital Expenditure.—Having framed these estimates of probable demand, the next thing to consider is the necessary equipment by way of capital expenditure to enable them to cope with it. In the majority of cases there are various possible alternatives. With a purely trading concern there is at least the alternative of various situations for the head-quarters—the question of the design for a new building, or the adaptation of an old building to new needs. In the case of a manufacturing concern there is, in addition, the question of machinery equipment; and here again there are probably various alternative types of machinery, producing approximately very much the same result, and requiring careful consideration before a selection is made. The same remarks apply to every conceivable kind of undertaking. Much time must be spent in settling the precise form of equipment; but as that time must, in the nature of things, be the time of experts other than financial experts, it only indirectly affects the present issue. It may be taken that all these problems will be settled by technical experts, and that so far as the financial problem is concerned, it will resolve itself into a requisition to supply certain stated funds at certain stated intervals to allow the work of construction to be carried out. In almost all cases, however, it is worth noting in passing, that the design for the equipment will require to be one as far as possible admitting of practically indefinite expansion. The promoters will want as far as possible to avoid the

necessity of replacing their original capital expenditure by something of a radically different type when the time comes that it is too small for their then extended output. This problem is, of course, in some cases far more difficult than in others; but the time to consider it in detail is clearly before any expenditure at all is sanctioned, as it can then be dealt with—so far as it is practicable to deal with it in advance—more satisfactorily than if all consideration of possible extensions be postponed until the need actually arises as a matter of emergency. On the other hand, it may be found quite practicable to arrange not to complete at once even the whole of the preliminary scheme. If it is expected that it will be some years before the demand develops into what may be called a "normal" demand, it will be undoubted economy (as far as possible) to delay capital expenditure accordingly, provided it can be done without sacrificing efficiency in the meanwhile, and without being obliged so to modify the whole scheme as seriously to increase the total ultimate cost. The reason for that lies in the fact that, from whatever precise source the capital may be drawn, it will be expected to produce some form of revenue almost immediately; and therefore, if any substantial proportion of the capital expenditure is not immediately productive, the financial results will be unsatisfactory *pro tanto.*

Time Occupied in Completing Organisation.—Carrying this idea a little further, it will be found that considerable difficulties may arise, if the process of equipment necessarily occupies a considerable time in construction before the business is able to commence profit-earning in any form. In the mean time arrangements must be made

for some return in respect of capital by way of interest—although no revenue is being received out of which to make it—or else those who provide the capital must be content either to allow this interest to run into arrear, or to forego all immediate claims for interest, in which latter event they will naturally expect a very substantial reward at a later stage. In practice it would be extremely difficult to obtain capital, save in quite small quantities, without arranging to make an immediate return thereon by way of interest during construction. Prior to the passing of the Companies Act, 1907, this meant that undertakings that required a long time in which to complete their equipment were virtually compelled to incorporate themselves under special Act of Parliament, so as to secure a statutory power to pay interest out of capital during construction; but under the Companies Act of 1907 (now section 91 of the Companies (Consolidation) Act, 1908), this same power was given to companies registered under the Companies Acts, provided the sanction of the Board of Trade was previously obtained in each particular case. The rate of interest so to be paid must not exceed 4 per cent., and probably 3 per cent. is likely to be the maximum rate normally authorised. In any event interest paid out of capital must not be paid for more than a clear half-year after the completion of the work. Such interest, whether it be paid by a parliamentary company or a registered company, if so paid out of capital, must, as a question of account be added to the cost of the equipment, and that undoubtedly is a perfectly sound way of treating it financially. It brings home to those concerned the fact that this delay in construction—inevitable

as it may be—is an adverse factor in the framing of financial estimates, involving, as it does, the raising of a larger sum than would have been necessary had the undertaking been able by any means to contrive for the immediate completion of the work. Delay in business almost invariably means pecuniary loss. Certainly it means pecuniary loss while in the meantime everything is lying idle, instead of being productive. The only kind of delay that can be profitable is the delay that awaits a suitable opportunity, instead of embarking upon an enterprise under adverse conditions, and that, of course, is an entirely different matter.

The Raising of Capital.—So far as capital expenditure is concerned, then, the estimate of the actual amount that will have to be raised for this purpose will depend primarily upon the estimates supplied by experts, and secondly upon the "loading" that may be necessary to cover interest during construction. The two together will represent the aggregate sum that has to be raised.

It is, of course, by no means necessary in all cases (or even in most cases) that the total capital required should all be raised at the outset. In so far as the promoters can arrange to raise the necessary capital by instalments, as required, they will to a corresponding extent be economising, as saving interest during construction ; but it is important to have everything settled upon a satisfactory and businesslike basis, so that those concerned may know exactly where to find the money from time to time for purposes of capital expenditure.

Working Capital.—This question of capital expenditure, however, is by no means the whole extent of the problem, particularly in connection with trading concerns,

and also to some extent with manufacturing concerns where large sums are required in connection with working capital, or floating capital. The working capital is required to provide for the delay that will ensue before the business can receive its profits in cash; and where, as in the case of a trading or manufacturing concern, considerable expenditure has first to be incurred on Revenue Account, in the purchase of goods and in the payment of wages, the amount of working capital required may be very considerable. Of course an estimate will already have been formed of the amount of trade, or business, per annum that is expected, both as minimum and as maximum figures. For working capital purposes the maximum figure must be assumed. Supposing the concern able to do a business of this stated volume, it is known in advance that this will not be an absolutely cash trade, but that the concern will have to lay out its money and wait for a return in the form of cash. First of all, there is the question of the stock of materials, or goods, which it will be necessary to hold, and to maintain from time to time, in order to give the undertaking a reasonable chance of being able to do the stated volume of business. That, again, is a point upon which practical experts ought to be able to give a very close estimate. Very largely according to the nature of the goods will depend the magnitude of the stock required to be held, in order to conduct a given volume of trade per annum. In some cases the stock may even have to be larger than a year's expected trade; in other cases it might be almost as little as a week's trade; but the point is one that is not likely to present serious difficulties to the practical expert. The actual amount of stock

that will have to be carried from time to time will probably vary according to the season of the year. Here, to be upon the safe side, one should as a rule estimate for the maximum, unless it is perfectly clear that the maximum may be provided for temporarily when the need arises, and that something rather less will be sufficient for the great proportion of the time.

Terms of Credit.—Having considered the question of the capital that has to be provided for investment in stock, the next question that arises is as to whether that stock has to be purchased and sold on cash terms or on credit terms. In so far as it is purchased on credit terms, it is necessary to take into account the period of credit (or the average period of credit) that is likely to be given; and to that extent any business may safely trade with its creditors' capital instead of its own. On the other hand, according to the credit that has to be given to customers, it will be necessary to provide additional capital to tide over the period between the sale of the goods and the date when the customers will pay for them. If the business is a manufacturing one, the average period occupied in the process of manufacture must also be taken into account, so that, assuming a good volume of trade, sufficient to provide a reliable average, there will be little difficulty in arriving at the amount of capital that must be provided, in addition to the capital provided in effect by trade creditors; this aggregate amount must be added to the estimate for capital expenditure, and represents the total amount of capital that will have to be provided to enable the undertaking to conduct to advantage a business within the limits of the estimated minimum and maximum output.

Overtrading.—The uncomfortable results following upon the actual trade falling considerably below the expected minimum are so obvious that it seems unnecessary to discuss them, but it is perhaps desirable to point out that any considerable increase beyond the expected maximum may have equally embarrassing results. Even when it does not reach the point that the equipment is inadequate, it will involve the necessity for increased floating capital, which must be provided by making special terms with creditors—always an undesirable proceeding, as being detrimental to close buying, and as tending to damage the financial reputation of the business; or, failing that, arrangements must be made as speedily as possible for an increase of capital, in the meantime relying upon such temporary means as may be available for raising loans for a short period just to tide over the difficulty. In extreme cases the result of this unexpected prosperity may be financial catastrophe. Cases in which prosperous undertakings absolutely fail owing to an excess of good fortune are naturally rare; but they exist in sufficient quantities to demonstrate the importance of making careful estimates in advance, and of not regarding every accession of business as an unqualified advantage, if it comes too quickly and unexpectedly. It may even be necessary sometimes to refuse business altogether, and to accept the consequences of so doing—which represent impaired reputation—rather than to attempt to cope with a business that is far too large to be handled satisfactorily with existing resources.

Borrowed Capital.—Passing on to the varying methods of providing the capital required, it is beyond reasonable dispute that, whatever the estimated capital expenditure

may be, it is necessary for financial stability so to arrange matters that the undertaking may have command of at least that amount of capital, without having to consider, and look forward to, the time when it will be called upon to refund it. The only satisfactory form of capital is one in which, so long as the business is continued, it may continue to remain as capital for its use. The raising of capital by methods dependent for their permanence upon the pleasure of the lender is always unsatisfactory, and can at best only be regarded as a temporary solution of an urgent difficulty. At any time the business may be called upon to refund these temporary advances, and if it is so called upon to refund, it will in all probability be at a time when it will be most inconvenient to find the money elsewhere. In the provinces one very often finds business houses carrying on medium-sized, and even large, businesses very largely with the aid of capital borrowed from a bank, by means of an overdraft (secured, in the case of individuals or partnership, by a mortgage on the business premises and fixed assets; and in the case of a company, by an issue of debentures giving them a fixed charge on all the business assets); if the Bank loan were a definite loan for a term of years, the practice would only be open to objection on the ground that sooner or later the date for repayment would come, and the concern would then have all its difficulties over again—that is to say, the only objection would be that it would not be a permanent solution of the matter. But when—as is commonly the case—the advance is repayable at quite short notice, if not on demand, it is clear that these concerns are practically trading on the slopes of a volcano; and that if there is at any time a financial

crisis, when the bank itself is in need of money, it will call in these loans and show very little consideration if the money is not forthcoming. As a satisfactory means of arranging for capital requirements Bank loans may therefore be regarded as entirely unsatisfactory.

There remains in the case of unincorporated concerns capital advanced by partners, or limited partners, and capital borrowed from outside sources. So far as the capital which is the property of the proprietors themselves is concerned, that naturally is a quite satisfactory form of capital—particularly if it does not represent the whole of the capital of the individual partner, but leaves him a certain margin for contingencies, so that he may not require to withdraw part of his capital for living purposes if profits are delayed. In the case of capital contributed by limited partners, or by mere creditors, the arrangement can only be satisfactory, if the advance be for a stated term of years sufficiently long to make it worth while to make use of the capital in the meantime, and to take the trouble of replacing the loan, or readjusting the arrangement, at a later stage when the first loan matures.

Debenture Capital.—In the case of companies the position is made very much more elastic, and it is for that reason chiefly that the Limited Liability Acts have become so popular. In addition to Debentures, it is possible to create different classes of Shares, the rights and privileges of which may be varied almost indefinitely according to circumstances. But even with regard to Debentures it is quite practicable, since the Companies Act, 1907—and has always been practicable in the case of parliamentary companies—to raise capital on

Debentures which are not repayable during the continued existence of the company. Such Debentures represent a permanent loan at a fixed rate of interest, and so long as that rate of interest be punctually paid, no matter what financial crisis (in reason) the company may pass through—or the trade in which the company engages may pass through, or even the whole country may pass through—the investor cannot ask for his money back, because under the altered conditions he thinks he can invest it more profitably to himself.

On the other hand, it is practicable to issue redeemable Debentures—redeemable either at a stated future date, or at (say) three or six months' notice dating from any time. An arrangement which is quite satisfactory from the point of view of the company is an issue of Debentures redeemable only at the option of the company, and not at the option of the Debenture-holder. That means that if the company finds that it can do without this capital, or can borrow it elsewhere at a lower rate, it may take advantage of the improved situation; but otherwise the bargain is permanent, and a worse bargain cannot be forced upon the company.

Preference Shares.—With regard to Preference Shares, the term is a very general one, implying nothing very exact, but as a rule a Preference Share gives the holder the right to be paid a fixed percentage of dividend out of profits only, with no right to any return if profits are not made. It is an arrangement therefore which, from the point of view of the investor, possesses several disadvantages as compared with the Debenture; but, on the other hand, the rate of return on Preference Shares is usually considerably higher than the rate of return on

Debentures—say, quite roughly, half as much again. Under normal circumstances the Preference shareholder never receives more than his minimum percentage, but in exceptional cases he will sometimes come in for a second distribution when ordinary shareholders have received a stated rate of dividend. That, however, is a very unusual arrangement.

Effect of having Different Classes of Share Capital.—The reader will perceive that, by a judicious splitting up of the capital required into different classes, promoters may cater for the requirements of different classes of investors, and thus more readily secure the capital that they are in search of. Suppose the case of a company which, having worked out its financial scheme, finds that the capital required will be ten times the annual profit that it can expect to make upon the business, and that perhaps during the first year or so the profits will be rather smaller. That may be taken as being a more than usually promising scheme; a very large number of companies are floated which certainly do not provide for a clear profit of 10 per cent. on the total amount of capital raised, or required to be raised. But if one were to try and raise subscriptions for the capital of a company which showed a reasonable prospect of returning 10 per cent. per annum, it is quite possible that one might find some difficulty in getting them. However that may be, absolutely no assistance could be looked for from any of the more prudent types of investor. It may even be said that it is a scheme that would not commend itself to any *bonâ fide* investor—it would have to be regarded as a speculation pure and simple. Certainly no trust monies could be invested in such a scheme,

and the aggregate amount of trust monies available for investment in this country is such a very large proportion of the total amount of available capital that it would be very imprudent to rule it out unnecessarily. Again, apart from trust funds, there are a great number of people—the majority of the more prudent investors—who, having made their money by hard work, have no mind to risk it unnecessarily in the later years of their life, when they reckon to have done with business worries. What they are seeking is not so much a high return on speculative investments as an adequate return, and one that is reasonably safe. Now, by dividing up the capital into different classes, promoters—if they have a sound scheme to start with—can offer each class of investor something that will appeal to him, and thus much more easily raise the required capital; and raise it on better terms, than if they had to appeal to one much more restricted class. Thus, suppose it is required to raise a capital of £100,000 in an ordinary commercial concern which may be expected to produce a profit of £10,000 per annum; and suppose further that the Fixed Assets (or Capital Expenditure) will be £50,000, and that the other £50,000 will be Floating (or Working) Capital. Now, if there is only one class of shares, it is clear that the promoters can only offer 10 per cent. per annum all round. But if the company has £50,000 worth of Capital Expenditure, it is a strange thing if it cannot provide an excellent security for (say) £20,000 4 per cent. Debentures, the interest on which will require £800 a year. The remaining £80,000 might be half in 6 per cent. Preference Shares, and the other half in Ordinary Shares. The Preference dividend will then

require £2,400 per annum, leaving £6,800 for the Ordinary dividend, which would work out at 17 per cent. per annum. The same principle will apply whatever the figures might be, and by this means it becomes possible to float a scheme which could not well be floated if only one class of capital were involved.

Debenturable Assets.—But before Debentures are issued it should be ascertained that, whatever happens, the company will be able to pay the Debenture interest, and therefore the total Debenture issue should always be kept fairly low. Another point to be borne in mind is that unless the company can offer satisfactory security for the Debenture issue, it will not be able to place it, because this class of investment appeals only to people who want safety above everything, and are not prepared to run any risks. Such a thing as a 5 per cent. Debenture may be taken as a contradiction in terms. No ordinary company would ever pay 5 per cent. to a Debenture-holder, because, if they have got satisfactory security to offer, they can—at all events in this country, where rates are comparatively low—always get what they require at a lower rate; but some companies, of course, possess little or no property that offers satisfactory security for Debenture-holders.

If there are no debenturable assets, but in other respects it is the same scheme, the promoters might issue half the capital in Preference Shares, and half in Ordinary Shares. Then, to pay 6 per cent. on the Preference Shares would take £3,000, and if the estimate as to profits is borne out, there would remain £7,000 per annum to divide among the Ordinary shareholders, which would still provide a dividend of 14 per cent. So

that where the scheme is one offering reasonable rates of profit, there is little difficulty in arranging the Capital in blocks which will commend themselves to different classes of investors, thus enabling us to spread our demand for capital over a much more extended area than would otherwise be available—a process which makes it much easier to place it upon satisfactory terms all round.

CHAPTER IV

THE ORGANISÁTION OF CONTROL AND RESPONSIBILITY

Collective *v.* Individual Control.—It is now proposed to deal with a few of the principal questions arising in connection with the organisation of control and responsibility as applied to business. To begin at the beginning, the first point to be considered is, as to how far it is expedient to allow supreme control to vest in individuals, and how far it is desirable to check the extremes to which perhaps individuals might go, by retaining the supreme control in the hands of some Committee, or Board of directors or managers. In this country, at all events, the individual supreme control seems rarely to exist—at all events in theory. Almost all important concerns that are not public authorities are operated by companies—either parliamentary companies or registered companies—in connection with which the control vests in a Board of directors; and in the case of very large concerns the Board is subdivided into Committees for administrative purpose. In the case even of those concerns that are not incorporated as companies it is unusual to find really large undertakings owned by, or managed by, an individual; generally there are several partners,

who take counsel together on all matters of vital importance, even although each may have in law, and in fact, practically supreme authority. The same principle no doubt applies—in theory at least—in the States. But there is this difference, that in the States it is quite usual to find that the President (who may be said to be equivalent to the English Chairman of the Board of Directors) has a much larger measure of control than is ordinarily vested in the English Chairman. His position is perhaps more like that of the English Chairman of Directors and Managing Director combined. He very frequently devotes the whole of his time to the business of the company, and is an expert in that particular business, as well as in management generally. Over here cases are by no means unknown in which very large powers have been vested in the Managing Director, but as a rule with no great measure of success. So far as this country is concerned, at all events, the cases in which the all-powerful Managing Director comes most to the front are where the company has failed under such circumstances as to involve a somewhat protracted inquiry on the part of the Official Receiver. Possibly for that reason we are inclined to look askance at anything approaching plenary powers being granted to any one individual; but on the other hand, it is well to remember that in many cases success depends in no small degree upon rapidity of action—the making up of one's mind quickly—and there can be little doubt that a Board of Directors, or even a Committee, is a somewhat cumbrous process of arriving at a rapid decision. To that extent the control of the individual—provided, of course, the proper individual can be found—would seem to possess

advantages; but in other respects it is thought that the system to which we are more accustomed in this country has the bulk of the advantages in its favour. It provides very much more effectively for continuity of policy than is possible under the rule of any individual. The supreme control of all matters by one individual—who, to be successful at all, must be exceptionally able—tends probably rather in the direction of dwarfing the faculties of his immediate subordinates, with the result that at the times when he is away (and of course no individual can invariably be upon the spot whenever wanted), the absence of this power, upon whom every one is accustomed to lean, is very likely to be felt with disadvantageous results; whereas, with a Board of Directors, one can at least ensure the presence of somebody having the requisite power to act being always upon the spot. One can in all probability ensure a reasonable continuity of policy from a Board. Further, the system is one which makes more for permanence of efficiency, in that it provides—perhaps unconsciously, but none the less effectively—a training ground for future heads; and this question of permanency is, of course, quite as important in questions of daily organisation and control as it is in questions as to the financing of a business at the start, or concerning its constitution generally. It is not sufficient, unless one is dealing with a purely temporary business, to formulate plans so as to ensure immediate good results. It may not perhaps be necessary to work for all time, but it is certainly necessary to work for the future, as well as to meet the requirements of the moment in a purely hand-to-mouth way; and so, in the long run, the system that makes for permanent efficiency will usually be found

to last longer than—and eventually to surpass—that which merely aims at a temporary success.

The "Open Door."—There is, however, another point upon which American and the British ideas of supreme control may be contrasted with advantage, where we have perhaps less cause to congratulate ourselves on our own methods. We are, as a nation, no doubt, rather great upon the subject of "the open door," and we are inclined to think that we fully appreciate the advantages of the principle of the "open door," and consistently apply them; but, if there is one point to which those at the head of important undertakings in this country do not apply the principle of the "open door," it is to their private offices. They almost invariably shut themselves up in a sort of inner sanctum, quite unapproachable to any one who is not prepared first of all to run the gauntlet through a small army of officials and secretaries, which involves their explaining their business several times over before any rumour as to its nature reaches the ears of any one competent to form a useful opinion as to whether what they have to propose, is, or is not, to the advantage of "the house." Of course one finds this in varying degrees, but the principle is almost everywhere in this country. In the States, on the other hand, practically any stranger may claim, and succeed in obtaining, an interview with the responsible head of the most important business houses with a delay of minutes rather than weeks. And not only every stranger; every employee has the same privilege. The "Head" judges *for himself* as to the utility of what his caller has to suggest: and he relies upon his own ability to terminate the interview speedily, if he thinks his time is being wasted. In this country,

on the other hand, an interview is rarely granted until the Head has been convinced, as a result of inquiries among his own immediate assistants, that something useful may result; that is to say, this important process of getting into touch with outside ideas is deputed to persons in comparatively subordinate positions, instead of being regarded as one of the most important—if not *the* most important—of the functions of the chief. Here undoubtedly is a direct opposition of views on a very vital question of business expediency, and it seems not altogether unreasonable to suppose that the superior adaptability of the American business man may largely be due to the fact that he gets so much more often into touch with outside ideas, and thus runs far less risk of getting fossilised than the Britisher, or of harbouring the delusion that his organisation and plans are perfect in every detail. Not even the most ingenious man can afford to assume that it is impossible for any one to have any useful notions to impart to him.

Concerning Employees.—On the subject of employees generally, it is, of course, only possible to speak in the barest outlines; but there are a few questions of general principle that may usefully be discussed, because it goes without saying that, where employees are numerous, efficiency and economy both require a high state of organisation, so that there may be no question of divided responsibility, or that there may be no question of undue delay as a result of cumbersome red-tape. There is also the question of efficient provision to guard against waste —whether of time, or of money, or of goods—which comes partly under this heading; but as this latter is perhaps more really a department of accounting, it need

hardly be considered here at length. With employees, as with principals, it is of course necessary to consider the qualifications that one is looking for. The question of Capital, which was one of the qualifications of principals, may well be left out of account altogether. The combination of the duties, or the functions, of an employee with those of a working (or sleeping) partner is a combination of the antagonistic, and likely to produce bad results, in the sense that it prevents those having the supreme control from having that full power over all subordinates that they ought to have. When employees are required to make substantial "cash deposits," the employment is, more likely than not, merely a device to secure extra capital at little or no interest. The position is probably extremely unsatisfactory from the employee's point of view, because his investment is anything but safe; but it is equally detrimental to efficiency from the point of view of the business, in that the man selected for the job—if indeed there be any *bonâ fide* work to do—is selected by reason of his qualifications as a capitalist, rather than for his qualifications in connection with the actual work that he will be called upon to perform.

Leaving out the question of Capital therefore, the qualifications of employees may be summed up under the headings of (1) ability and (2) connection. Connection, of course, is only required with quite a limited number of employees, attached to the department—whatever it may be—that is equivalent to the Sales Department of the business. Ability, therefore, is paramount; but one ought perhaps here to add another quality, that would quite naturally be taken for granted in the case of principals on account of their obvious

interest as capitalists, namely (3) loyalty to the business —an all-important point in connection with employees. Particularly, of course, is loyalty all-important in those large concerns where it is practically impossible for the personal influence of those in supreme command to reach in every direction, and right to the end of every channel. In the nature of things a great deal of the work done by employees of all classes must be work that cannot be effectively controlled or supervised on the spot and at the moment. One must, of course, as far as possible aim at controlling it. One aims, to an even greater extent possibly, at checking the work afterwards, with a view to repairing mistakes (if any) at the earliest possible moment. But there will always be a certain margin of possibility of evil being done to the business as a result either of inexperience, inefficiency, or even of deliberate intent.

Importance of maintaining an Efficient Staff.—In general terms, doubtless the best work is the cheapest in the long run. That seems, indeed, almost an axiom; but two points must be considered here. The first is that, as a rule, the demand for first-class work is greatly in excess of the supply, and consequently (following up the idea) a staff must be selected not merely for the immediate present, but also for the future. We must necessarily include in our staff of to-day some who we hope will occupy more leading positions to-morrow, but who in the meantime, in the nature of things, cannot yet be ranked among the first class. In some walks of life these "learners," if they may be so described, are avowedly in that capacity, as apprentices, or (in some professions) as articled pupils; in other cases the line is not by any means so clearly

distinguished. But in any event, it is not sufficient that the staff at the present moment should be thoroughly able to cope with the work that comes to hand from day to day, unless one can satisfy one's self that the "new blood" coming into the business house is sufficiently vigorous, and sufficiently able, to make good the wastage that must inevitably arise in connection with the lapse of time. One is familiar with the idea of Depreciation as applied to inanimate objects, such as plant and machinery, but one perhaps rarely appreciates that the same process applies also to human beings—with, of course, the material modification that here the Depreciation is a phase that follows a phase of Appreciation. Regarded as a machine for the production of work, the human being no doubt appreciates as he becomes more familiar in his duties and gains experience in the sort of work he has to perform; but that is a state of things that does not go on for ever. It is followed by a period of Depreciation; and, although one cannot possibly lay down any invariable rules, the latter process is usually so subtle as not to be discernible until it has gone a good way. Capacity for work may be the first thing to go; if so, it will probably not be noticed until some time of exceptional pressure comes. On the other hand, while Depreciation is actively in operation in some respects, there may be steady appreciation in others. All those qualities which are dependent upon experience and judgment will no doubt continue to increase for a considerable time after those qualities dependent chiefly on general health are on the decline, and the loss necessarily incidental to depreciation may therefore in many cases be avoided—or at all events deferred—by a judicious change of duties. As a

matter of fact, such a change of duties, to correspond with the natural Depreciation of the human machine, is really one of the commonplace features of all business life. The junior members of the staff are almost invariably more hardly worked physically than the senior members, but the work they have to do is probably infinitely less worrying—unless, of course, they are of exceptional ability, and therefore are placed in positions of considerable responsibility at an age earlier than the average.

Promotion.—But, as arising out of this question of the change of duties from time to time, which is a natural process in the development of each individual member of a large staff who remains in the employment of the house, it is well to remember that the process can only be economical from the point of view of the house, if the matter be regarded from an extremely far-seeing point of view—as building for the future, and as providing for as efficient a senior staff in the future as exists at the present time. From the more immediate point of view it is certainly bad economy, directly a man, or a boy, has proved his ability to discharge one set of duties in an entirely satisfactory manner, to take him off that work—which he thoroughly understands and can do well—and put him on to something else, which (in the first instance at all events) he will either not do so well or not do so rapidly as others. Such changes are essential, however, from two points of view: first, to provide for the staff in the future; and secondly, to ensure that the present staff shall consist only of persons capable of development. If a business house can only offer employment which provides no capacities for future advancement,

in the nature of things it will have to select its staff from a much more limited supply, from which those whom it would probably be most desirous of employing are altogether excluded. Thus it is quite possible to take too narrow a view of the relationship between expenditure and immediate result. In a sense the connection between salaries paid and work done should, perhaps, be as direct as anywhere; but not if one is laying one's plans for the future, or at all events not always so. There is one more point to be considered before leaving this question, and that is the possibilities of advancement for the individual employee. In some cases—particularly, of course, in Government employ, but also to a great extent in banks and other similar concerns —promotion goes very largely by seniority. There is very little inducement for exceptional effort. Certainly this is not making the best bid possible for exceptional effort, or for any special initiative. In the case of a very large concern it must be admitted that promotion upon any basis other than seniority is extremely difficult—involving as it does the question of selection, and raising the point as to who is to make the selection, and whence they are to get the information upon which they may base their decision—but here, perhaps, the American shows the soundness of his "open door" principle. The American "boss" probably knows every member in the employment of his house by sight, and by name, and has more than a shrewd opinion as to the abilities of each; with the result that he is rarely at a loss as to making a wise selection when the need arises. It may, of course, be that the selection is not the best possible, and that he may have overlooked the most suitable man;

but, at least from his point of view, he is able to produce —to provide himself with—a better man than any system of mere seniority would be likely to give him; and, apart from that, the efficiency all round is no doubt stimulated by these possibilities of rapid advancement. There is, it is thought, too much tendency in this country to hold back able young men, merely because they are young.

Wanted, a Financial Officer.—By way of conclusion to this chapter, attention may be drawn to another difference in American and British organisation and control which seems to tell rather in favour of the American. Practically every American Company has an officer called a "Treasurer." The duties of the Treasurer are not those that we associate in this country with the word, as a man who is physically responsible for the safeguarding of treasure, nor is the Treasurer a mere book-keeper. He is rather a man equivalent to what might be described here as the Chairman of the Finance Committee, if we had such a thing. Very large concerns over here do have, of course, Finance Committees, and these committees have chairmen; but the idea of having, in connection with a comparatively small concern—an ordinary business concern—some one with practically plenary powers in matters of finance, and financial policy, is one for which we have no equivalent, except, perhaps, that general utility man, the Managing Director. But the question of finance in connection with any business is a matter well worthy of being separated from general administration, and dealt with as a speciality by a proper and competent expert. There can be little doubt that, from the narrowest point of view, such a man could always earn his pay in the savings he would be able to

effect; but, apart from that, the presence of a man whose sole duty it is to keep his finger on the financial pulse of a concern leaves those more responsible for the practical development of the business free to go ahead in their own special departments, without any haunting fear that they may find themselves in trouble by reason of over-trading. It is not necessary for them to dissipate their energies by looking after two things at once. The development of a growing business is quite enough for any one brain to consider, without having at the same time to solve the difficult problems of financing that growing business. Moreover, it is very unlikely that the two duties can be satisfactorily performed by one person at the same time, for the simple reason—if for no other—that it would be too much for any one man to do; but, apart from that, the qualities required for each set of duties are fundamentally different, and it is just as desirable that we should have specialists in this direction as in any other. That we have not done so up to the present is, it is thought, largely due to the almost illimitable conceit of the average Britisher, who in his heart of hearts think that he can do everything without the assistance of specialists, and has little confidence in specialists of any kind. Even to the present day there are men who think they know more about law than any lawyer; there are a very large number of persons—the great majority of business men, one might almost say—who consider that nobody can teach them anything about accounts; and so on with regard to every conceivable form of specialisation. To them the idea that any one could finance their business for them, better than they can do it for themselves, would probably be regarded as

even more absurd than to suggest that they are not better lawyers than the lawyers themselves, or better accountants than accounting specialists. Until the importance of specialisation in this direction is appreciated, we shall no doubt continue to "muddle through" in the majority of cases in the typical British way; but at the usual heavy expenditure in the way of lost energy and lost wealth.

CHAPTER V

THE ORGANISATION OF CONTROL AND RESPONSIBILITY—(continued)

The suggestion put forward in the preceding chapter of establishing a "Treasurer" as the head of the finance department of a business, upon the American system, is, of course, merely one application of the general principle that one always expects to find in evidence in cases where there is any approach to real organisation—of separating the necessary duties, and apportioning them among the various available members of the staff in such a manner that (as far as possible) these various members may be employed in automatically checking the work performed by each other. As applied to questions of accounts, this arrangement is commonly spoken of as a "system of internal check," but the same general principle can, of course, be extended very considerably beyond the mere Accounts Department, and with equally satisfactory results. It is, however, not sufficient to be clear as to the extent of the responsibilities of each member of the staff, and each department of the business; if this work of subdivision be overdone, very undesirable results are liable to ensue.

Individual Responsibility.—On the question of the

precise extent of the responsibilities of individual members, it is rare to find in commercial, mercantile, or manufacturing businesses that any real pecuniary responsibility is insisted upon as against individuals, except, of course, in regard to what we may call criminal matters. Apart from criminal matters, efficiency is enforced by either one of two methods, or by both combined: by making remuneration, in one form or another, dependent upon satisfactory results; or by making a continuance of the engagement itself dependent upon satisfactory results. In some cases—for instance, in connection with the Army, a much more direct responsibility is enforced upon officers, who (in certain circumstances) may be held pecuniarily responsible for the acts and defaults of those under them, as, for instance, when they have themselves neglected to comply with regulations. At first glance this may seem to be unduly harsh. It must be remembered, however, that this responsibility does not really extend to efficiency, for there is here no direct test of efficiency that can be reduced to a money basis. At most it works so as to require superior officers to guarantee the honesty of their subordinates, and inasmuch as they are supposed—at all events in theory—to be able to protect themselves efficiently against the dishonesty of these subordinates by conforming strictly to regulations, and are only held responsible when they have failed so to do, the idea that they should be held responsible for losses sustained through what is thus regarded as a breach of their own duties does not seem perhaps particularly far-fetched, although it is certainly carrying matters further than is usual in business circles. The unfairness, if any, seems to be rather that

the regulations themselves are perhaps not always capable of strict performance. The position in practice seems to be, that if, as a result—or as an assumed result—of inefficient supervision, a subordinate has been able to cause loss to the Department, the officer is called upon either to make good the loss or to resign. In commercial circles, under similar circumstances the probability is that he would hardly be given the option, and thus it seems that of the two the military system is really the more lenient; but it need perhaps hardly be added that an officer who exercises the option, and decides to pay up, is hardly likely to be marked out for future promotion if the matter has been at all a serious one. Thus there does not really seem to be any very practical difference between the two methods, when closely examined, except that perhaps under the Army system the way is paved for the inefficient officer to retire more gracefully than would be permitted under the ordinary commercial system.

Risks of Friction.—Apart from this question of actual financial responsibility of individuals, while fully recognising the importance—and even the necessity—of dividing the work up into sections (that is to say, of organising both the work and the staff), it is well to remember that the effect of so doing may easily be not merely to arrange that one group of individuals is set up as a sort of automatic check upon another group, but also that one is bringing into existence groups which, in the absence of great circumspection, may tend to become rival groups, intent perhaps more upon scoring off each other than on advancing the welfare of the undertaking as a whole. This is particularly likely to occur where two

such departments have mutual chances of criticising each other. That, however, is a difficulty that can very often be got over by formulating the system of organisation upon the usual business lines of not setting up any two groups (or individuals) mutually to check each other, but of working the organisation round in a sort of circle—so that if A checks B, B shall not check A, or be called upon to criticise A in any way, but some other individual or group, say C; and so on round in the circle. In that way, even if one group considers itself to have been unjustly treated, it has little or no temptation to waste time and energy by trying to get some of its own back at a later stage.

Employees *v.* Agents.—To turn to another matter: in connection with practically every business, or other form of activity, there will be certain classes of work which have to be performed only intermittently, or have to be performed at distances so removed from the centre of control that the question arises as to whether it is really desirable to provide for these duties to be performed by members of one's own staff; or whether, on the other hand, it is not better to arrange for them to be performed, when necessary, by others. This is, of course, largely a question of convenience, and the requirements of each case must be considered before arriving at any definite conclusion. Take, for instance, a concern which for the furtherance of its objects requires to have representatives scattered through many towns, or many countries. If the concern be of sufficient importance to make it worth while, it is quite possible that those interests will be best served by establishing branches in these various centres of activity, and manning those branches

with permanent employees under a branch manager exclusively employed in the service of the undertaking. It may well be, however, that the profits capable of being derived from each of these local centres will not justify the employment of an adequate number of men engaged for the whole of their time; or it may even be that the profits will not be sufficient to enable the services of a competent local manager to be paid for, stipulating for the whole of his time. In such cases, clearly, one must fall back upon local agents, who are not required to give the whole of their time, and are therefore free to increase their income by other work. In this way one can in many cases obtain the services of local representatives of greater ability, or of greater local influence, than would have been possible for any fee that the business could afford to pay for their exclusive services. A case, illustrating this problem perhaps as well as any, is that of insurance companies. In large provincial towns, and in certain foreign countries and colonial possessions, the leading Insurance Companies find it best to establish branches under local managers, with a permanent staff according to their respective needs. Where, however, the prospects do not seem sufficient to justify this expense, they may yet tap the district by the aid of agents; and in the great majority of instances they will find it worth while to employ agents even in districts where they have branch managers, because through the instrumentality of these agents they are able to secure business which their managers unaided could not control. The branch manager in such cases will probably serve not merely as a manager of the branch business, but also as a local inspector of agents, and that no doubt tends for efficiency

all round. But in more scattered districts a local inspector of agents becomes much more difficult, or even impossible; then recourse must be had to travelling inspectors, and as the districts become more and more scattered, naturally the visits of these travelling inspectors will be rarer.

Expanding Organisation.—It should be remembered, however, that the prudent man of business does not invariably arrange his organisation solely in the light of present profits. If, as a result of his inquiries, he is of opinion that there is scope for development, he will often best show his ability by increasing expenses, and increasing his organisation to an extent perhaps out of all proportion to present profits, knowing that in order to secure rapid development it is often necessary to supply facilities in excess of the then existing demand. The question of remuneration will be more fully discussed later on; but it may be mentioned at this stage, that, as a rule, it is thought—and no doubt rightly thought—best to pay agents who do not give the whole of their time to the business in hand almost entirely by results.

Staff *v.* Professional Audit.—Another point on which a question will frequently arise, is as to how far it is desirable to employ outside assistance, and how far it is better to meet the requirements by increasing and further developing and organising the staff, is on the subject of check and audit. For the reasons already stated, practically all important concerns are owned not by individuals, but by collections of individuals, whether incorporated or unincorporated; and for the satisfaction of this numerous proprietary it is, of course, necessary to institute some sort of a periodical inquiry into the manner in which the

responsible managers of the business are conducting its affairs, and for that reason—and probably chiefly for that reason—a professional audit of the accounts of all important concerns is practically universal. The chief exception is in the case of those public bodies where it has been thought expedient, in the interests of efficiency, to provide for an audit through the medium of a Government department; but here again the audit possesses the same essential quality as the professional audit—it is an inquiry into the accounts, conducted by persons who are in no way controlled by the real accounting parties—*i.e.* the managers of the business. To serve this purpose of reassuring the proprietary, or those who have contributed (or are responsible for) the necessary capital to conduct the concern, an independent audit of some kind is obviously essential; but the question legitimately arises as to how far it is necessary that the external audit should go into detail, and how far it is practicable, or desirable, that the detailed work in connection with the verification of the accounts should be performed by members of the permanent staff. In practice the problem may be considered very largely to have been solved in the case of most large concerns by the creation of some system of internal, or staff, audit. This is so not merely in connection with railways—often to a large extent it occurs with local authorities, and in many manufacturing and commercial houses conducting business on a large scale. They arrange that the detailed work shall be mutually checked by the staff, on a system of circles in the way already mentioned when touching upon internal check; or by arranging a definite "audit department," even if that department merely consists of

one man, as is of course quite sufficient in moderate-sized concerns. The staff audit cannot, of course, be regarded as a satisfactory way of determining questions of principle, or of finally verifying the accounts of the accounting parties who have actually appointed the staff auditors; but, so far as it goes, it may reasonably be relied upon as doing this work both honestly and efficiently; and there can, it is thought, be little question that the checking will be carried out more minutely in the hands of a staff auditor than it is ordinarily likely to be in the hands of professional auditors, while the cost will be very considerably less. The principal limitations of the staff audit are that occasionally difficult and technical questions may arise which the staff auditors are not sufficiently experienced to deal with, or not sufficiently strong to insist upon being dealt with against the wishes of the accounting parties; consequently, if there is anything radically wrong—and it is, of course, only on the off-chance of there being something radically wrong that the external audit is required—it is not impossible that the accounting parties will have secured the appointment of staff auditors who may be relied upon to do what they are told.

Organisation and Facilities for obtaining Additional Capital.—From the point of view of any concern that may at some future date require to raise further capital, there can be little doubt that the assurance of the external audit is a valuable asset, likely to enable the concern to achieve what it requires, or may require in the future; and this question of the facility with which additional capital may be raised at some future time is a point that can never be overlooked with safety by the

man who has his eye upon the future, and on the permanent success and development of the business in hand.

It is this question of the facility for raising future capital that induces railway companies, for instance, to "split" their Stock, exchanging an unwieldy Stock that stands at a high premium, and is not particularly marketable, for two classes of Stock—Preferred Stock and Deferred (or Ordinary) Stock—thus bringing into existence stocks that are more readily marketable because a greater number of persons can be found willing to possess either, or both. The operation of splitting in itself involves a dead loss to the company that undertakes it: the only posssible advantage to the company is that, having exchanged unmarketable Stocks for marketable Stocks—Stocks not readily marketable for Stocks in which there will be a good market—when the need arises later for the raising of additional capital it can be raised more readily, and upon better terms.

Technical Departments.—The same remark applies with regard to other matters besides the audit. Technical services of all sorts are from time to time required by practically all concerns, although perhaps less regularly, or less continuously, than the services of the skilled accountant. In many cases, for instance, legal advice is required; and here, of course, it is absolutely necessary to have recourse to the assistance of professional lawyers, not only because any other course would be foolish in the extreme, but because under the law of this country many classes at least of legal business can only be performed at a profit by solicitors. It probably goes without saying, that, in all save purely routine matters, where

experience has made it perfectly clear what the law may be, money spent on legal advice is by no means spent unproductively ; but there is still the alternative of employing solicitors as required, and paying them for the work they actually perform, and of having a standing arrangement with solicitors to perform whatever work may be required from time to time. In the case of large concerns it is by no means uncommon to find qualified solicitors upon the permanent staff, and a regular Solicitors' Department, competent to deal with legal questions as they arise. Here it would seem that the problem is somewhat similar to that arising under the question of agents, as contrasted with branch managers. One has to consider whether the amount of work that will have to be disposed of is sufficient to justify the employment of men of sufficient training and position to do that work in a manner satisfactory, or whether it would not be better to employ outside assistance when the need arises. As a matter of fact, all those concerns which have a permanent Solicitors' Department would feel themselves quite free, when exceptionally important points arose, to take additional advice from outside firms. Moreover, in many cases, of course, the difficulty is solved automatically, by reason of the fact that the legal profession is divided into two branches—Solicitors and Barristers—the latter of whom are usually employed to advise on all questions of serious difficulty. Counsel's opinion could probably be obtained just as well by the members of a permanent Solicitors' Department as by employing the most celebrated, or expensive, firm of outside solicitors. But, for purposes of litigation, it is quite possible that a little "stiffening," or strengthening from

outside, might be advantageous, and there is nothing in the existence of a permanent Solicitors' Department rendering that impossible, or even difficult. But a sort of "halfway house" may well be found to meet the requirements of concerns of only moderate dimensions, and it represents an arrangement that seems fast to be coming into popularity; namely, that of paying a fixed annual fee to an outside firm of solicitors, which fee is to include all work that they may be called upon to do. A limitation of the system introduced is, that the standing or retaining fee is to cover all advice and attendances, and so on; but not litigation. Or another arrangement is, that it is to cover the costs of litigation, if those costs should be payable by the employing house; but to leave the solicitor free to recover his costs from the other side, if the Court so directs, or if the dispute be settled upon those lines. Like many compromises, there seems to be a good deal to be said in favour of this one. Unless there is a very considerable amount of legal work, it is possible that suitable arrangements could be made with a first-class firm of solicitors at a cost certainly not in excess of the cost of a permanent Solicitors' Department, which would in case of need give the concern the benefit of far more skilled and experienced services than could be expected from any permanent member of a permanent staff.

Debt Collecting.—For purely routine legal work, such as debt collecting, or the preparation of leases or agreements of letting in the case of an undertaking so engaged, there is nothing to be said in general terms against the permanent Solicitors' Department; but there are, of course, quite a number of business houses which,

while they are obliged occasionally to have recourse to solicitors for the collection of debts, are sufficiently fortunate not to have to do so often enough to render necessary the organisation of a special permanent department. For this particular purpose the employment of outside houses, at fixed terms, is very common. These may either be solicitors, or so-called "trade protection societies"; but in the latter case, of course, the trade protection society will have their own permanent solicitors, who acts for them under a fixed arrangement. This is mentioned in passing, as an instance of specific classes of work that may be "farmed-out" with advantage, instead of a business attempting to deal with it itself; but in connection with debt collecting, it is as well to bear in mind that it represents by no means the most elevated branch of the legal profession, and that therefore special care is necessary to see that it is deputed to suitable persons. A business house may easily lose reputation through undesirable methods on the part of its agents, even if those agents are merely trying to recover overdue accounts; and another point that ought perhaps not to be overlooked is that, the debts having been collected, have still to be accounted for by the collectors before the matter can be regarded as settled. A very good way of dealing with all debts in the hands of collectors not in the permanent employment of the undertaking, is for them to be transferred to a special ledger. The balances outstanding in that ledger then represent debts for which the debt-collecting agency has to account as and when actually received; they have therefore to be paid over in due course, or to be explained in whatever manner may be

possible under the circumstances. By collecting all these accounts into one ledger it is far easier to control matters, to check the remittances received from the debt collectors, and generally to supervise their work and test its efficiency.

CHAPTER VI

THE REMUNERATION OF EMPLOYEES

Nature of the Problem.—The problems arising in connection with the remuneration of employees are among the most difficult arising in connection with practical management. From the point of those who have to secure, for the benefit of their respective businesses, employees capable of rendering the required services, the case is analagous to that of a manager who, for the purposes of his factory, finds himself required to purchase stated quantities of materials, and to provide a continuous supply of those materials so that his works may be kept going. Very much the same problem arises in connection with the supply of those who have to look after the various inanimate machines, and to turn the mere shell of the business into a productive whole.

The Human Element.—There seems to be little advantage in attempting to divide labour of this description into different classes. The problem is, after all, very much the same problem in every case. That is to say, in all cases one has to deal, not with machines, but with human beings ; and one has to deal with them in such a way that they will be contented, if the best results are to be achieved. Unless at least content—if not perfect satisfaction—can be secured, it is practically

certain that an appreciable amount of the energies and ingenuities of the staff will be devoted to considering their own interests rather than the interests of the house; and this means a serious loss by way of friction—probably, in the long run, one of the most expensive wastes possible.

On the other hand, of course, one has to consider, at all events in connection with commercial concerns, the fact that a business house obviously cannot afford to pay for more than it really gets; and even in connection with concerns not run for the sake of a commercial profit, the same problem (or very much the same problem) arises, in that the demand for funds generally exceeds the available supply. There is always scope for further useful expenditure, beyond that which can be provided out of the monies set aside for that purpose; so that here, just as much as in the case of a commercial concern run for an immediate profit, there is scope for, and necessity for, strict economy in the sense of seeing that the largest possible benefit is received in exchange for all expenditure.

Fixed or Variable Rates.—Perhaps the first point to be considered is as to whether the employer shall offer, in exchange for the services he requires, fixed payments, or payments varying with the actual results achieved. There is a good deal to be said in favour of each system. This inquiry, of course, to be pursued exhaustively, involves a careful study of Profit-Sharing, of how far various profit-sharing schemes have succeeded in the past, and as to the precise causes of the failures of those that have proved unsuccessful. Some information on this point will be found in Chapter XV., which may usefully

be referred to in this connection; but in the first instance, it is thought best to deal with the general purposes involved, rather than to rely entirely upon the results of past experiments in profit-sharing, which after all are not sufficiently numerous to admit of any very reliable deductions.

Minimum and Maximum Rates.—*Primâ facie* it may doubtless be admitted that the ideal system of remuneration is one which will, as nearly as possible, give payment for the actual value received; and that therefore, as the value received will doubtless vary from time to time—partly owing to circumstances under the control of the worker (as, for instance, his efficiency, or ability, or care, or the speed at which he can work), and partly owing to causes beyond the control of the worker (as, for instance, the amount and kind of work that the employer is able to give him to do)—the ideal system of payment will be one varying to a like extent, provided a satisfactory basis of measuring the extent of these variations can be agreed upon under all possible circumstances. Even in the absence of such an agreement—which would probably be quite unattainable in practice—it seems safe to say that, when one is dealing with ordinary human beings, direct encouragement is perhaps the best incentive towards special or unusual effort, and that therefore a scale of payment to some extent varying with results will be likely to produce the best results. But a varying rate of payment, to be consistent, and to be financially possible on the part of the employer, must vary according to circumstances, some of which (as has already been stated) are beyond the control of the worker. In the majority of cases the worker for the time being looks

to the employer for his whole income, and has little else to look to, or he would hardly be in that position; the consequence is that he is not really in a position to adhere under all circumstances to a bargain under which extreme fluctuations of income might occur. For the arrangement to be permanent, there must at least be a minimum scale of pay, and that—apart from the financial strain it imposes upon the employer—to some extent militates against the whole idea; for it means that, just at the point when perhaps special effort would be most useful, the inducement to put forward that special effort does not exist. On the other hand, to compensate for a fixed minimum it seems only reasonable that there should be something in the nature of a fixed maximum remuneration, with the result that no really adequate compensation is provided for exceptionally valuable, or useful, services. Nevertheless, it would seem that, practically, it is only within certain limits that a varying scale of pay can be adopted permanently some such limitation must be accepted as one of the realities of life in cases where the whole of the time of the employee is devoted to his work. In cases where exclusive services are not retained, and when the employee has in consequence other sources of income, payment may well be entirely based on results; but hardly in other cases. Another point to be borne in mind is that there is probably little advantage in varying the scale of pay, unless it be varied in accordance with something more or less within the control of the employee, for the primary object of a variable rate is, of course, to induce the employee to exert himself to the uttermost for the good of the house.

Effect on Results.—Next must be considered the effect of such an arrangement upon the employee's actions, and (possibly) upon the records of transactions that may be under his control. Take the case of a person in a position of minor responsibility, but still of some responsibility, and suppose it be arranged that his remuneration shall be dependent partly upon results that are within his control—say, for instance, upon the quantity of goods that he is able to sell. This may be a very excellent arrangement in the case of a cash business, and undoubtedly it does help to make efficient salesmen; but it would be a somewhat ruinous experiment to apply in the case of a credit business, unless there was some one in a more responsible position who was entitled to determine, without any possibility of argument, whether or not credit was to be given on all occasions. There would never be the least difficulty, of course, in finding purchasers for goods, if no inquiry were made as to their ability to pay for these goods afterwards.

Effect on Records.—Then again, in cases where remuneration is based partly upon results in connection with those who have some responsibility for the records in books of account, one certainly cannot afford to overlook the fact that their self-interest *may* bias them as to the true effect of those transactions. Perhaps the simplest case of this description is where a manager's remuneration depends, in whole or in part, upon the profits of his department. Such an arrangement undoubtedly has the effect of encouraging him to make the profits of his department as large as possible; but equally does it encourage him—if the profits are unsatisfactory,

and if he is at all that way disposed—to attempt to exaggerate the profits. In many cases one is largely dependent upon departmental managers for certain items of information, while it is often difficult to place it beyond the possibility of such managers to exaggerate profits for the time being. Sooner or later, no doubt, the exaggeration will be discovered; but that, of course, is not everything.

Effect on Finances.—To go a step further, if one makes the remuneration, say, of a Managing Director dependent upon profits earned, or dividends paid, the tendency clearly is to encourage the payment of large dividends. In so far as the arrangement does not have that effect, it can hardly be said to have any particular value at all; but in so far as it does have that effect, it is at least open to question whether the effect that it is producing will invariably be desirable. If one could so arrange, it would be better doubtless for the commission to be based rather on the profits earned but *not* distributed, as tending towards a sound basis which would no doubt provide for the permanent prosperity of the undertaking; but that would be hardly a practicable arrangement, it is only mentioned here to illustrate the difficulty of fixing any basis for variations in rates of remuneration that will not occasionally produce results at least as unfortunate as a fixed rate of pay.

Prospects of Promotion.—Assuming that differential rates be abandoned altogether as an inducement towards increased efficiency, the employer has, of course, to fall back almost entirely upon the permanence of the appointment that he has to offer, and the prospects of advancement open to those who satisfactorily discharge their

duties. In the majority of cases the author is inclined to think that such an arrangement is more likely to lead to the best results, provided the scope for advancement is reasonable; but if the scope for advancement is limited to a very small proportion of the employees, it is clear that it will not prove a very powerful factor in encouraging efficiency all round. Those who consider themselves within measurable distance of the possibilities of advancement will doubtless be impressed by these possibilities, but hardly the general rank and file. On the other hand, perhaps the employer may not expect, and may hardly wish for, any special effort on the part of the rank and file; if he can only induce those who really have capacities for development to exert themselves to the uttermost, it is quite possible that he will be quite satisfied with the result.

Deferred Pay.—Apart from questions of advancement, another inducement to lengthy service is, of course, some scheme of deferred pay. Whether the scheme involves actual deductions from the stated remuneration of the worker which are accumulated for his benefit (possibly with additions thereto), or whether the deferred pay is entirely in addition to the scheduled rates of remuneration is, of course, a mere difference in form. In substance it is merely an arrangement for part of the pay to be held over and paid at a later date, subject perhaps to possibilities of forfeiture. What the possibilities of forfeiture may be will, of course, depend entirely upon the precise nature of the scheme; but there is one arrangement of this kind to which attention may be drawn, as certainly seeming not calculated to produce the desired result of retaining the best workers permanently in the

service of the house, and that is where a scheme for deferred pay is associated with specific deductions from present pay and possibilities of advancement quite inadequate to provide reasonably for the development of the junior staff—a state of affairs which very commonly exists in connection with Banks. In such cases there is a genuine grievance, that those who leave the service of the house after a comparatively small number of years —not necessarily very quickly: merely because there is no scope for advancement—lose the benefit of their contributions entirely; indeed, it may be said that, substantially, the pensions of those who do eventually earn the right to pensions have in such cases been paid, at all events in part, by compulsory deductions from what may, by way of comparison, be called the non-permanent staff. There is no hardship, of course, in the sense that the arrangement was doubtless properly explained beforehand; there is no hardship, because any one who does not like to stay is free to go when he pleases; but at the same time, although the sense of hardship may not be very justifiable, it may easily become sufficiently real to form a genuine grievance. And even a fictitious grievance militates against good results. Speaking in quite general terms, Banks seem to fail to retain, at all events, all the best members of their junior staffs, which certainly cannot be regarded as an ideal arrangement. If it does not seem worth their while to find suitable positions for all those who are capable of development, then it would seem that they could do with a class of men less capable of development, at all events to some extent, and thus might effect considerable economies in the pay that they make to the younger of their workers. It is often

desirable to pay those capable of development more than they are really worth at the time, and to develop them upon one's own lines; but there is little to be said in favour of the luxury of employing such men, if one is unable to keep them.

Employment for Fixed Term.—The next question calling for consideration is the respective advantages of having agreements for employment for a fixed term, as against an arrangement which may be terminated at comparatively short notice by either party. Speaking generally, the fixed agreement would appear to be almost entirely in favour of the employee. Little good work will ever be got out of a man who wants to go, but cannot because he is under agreement. Whatever the precise terms of the agreement may be, in the great majority of cases, if a man wants to go, it would be far better in the long run to let him; and, if that be the case, an agreement for a term is clearly wholly one-sided—that is to say, one which may effectively bind the employer but will not effectively bind the employee. The only exception seems to be in connection with apprentices, who sometimes may not know their own minds. They may perhaps have wished to go at one time, and may afterwards be very glad that they were bound down, and therefore unable to do as they wished; but little good work will ever be got out of a discontented man, and unless, therefore, the discontent is a purely passing phase, it would be far better to cut the connection at once, no matter what the agreement may be.

Importance of Equitable Arrangement.—In the long run permanence in the relations between employers and

employed rests on the fairness of the terms of the employment, and they must be regarded as fair by both before the results are likely to be really satisfactory. Their intrinsic fairness matters not at all. Even assuming it were capable of being ascertained, it would be beside the point. What is necessary is that both parties should be satisfied with the arrangement, and therefore willing and, indeed, anxious to continue it, and to put forward the best efforts they are reasonably capable of to secure its continuance. The difficulty, of course, is that, where uniform payments have to be made, and in consequence the advantage to be received in exchange by the employer necessarily fluctuates considerably, in times of exceptional slackness he may get tired of an arrangement which for the time being involves more payment than receipt. And *vice versâ* in times of exceptional stress; and such a state of affairs is naturally most apparent in cases where owing to exceptional activity the needs of the employer are at their greatest: for a uniform rate of pay, to be financially possible to the employer, must necessarily be considerably below the maximum capacity of the worker, bearing in mind that the pay has to be the same in quiet times, when less than the maximum capacity is being asked.

It will be observed that no very definite conclusions have been reached upon this subject of the best method of remunerating employees. The reason is that, in the opinion of the author, no hard-and-fast rules, of universal application, exist, and, moreover, a system that would produce excellent results under one man might prove wholly unsuccessful under another. The problem is essentially a problem in psychology, rather than in

mathematics ; hence the hopelessness of attempting to arrive at any general conclusions of universal application. It is hoped, however, that the various considerations to which attention has been drawn will be thought to be not altogether beside the point.

CHAPTER VII

THE REMUNERATION OF WORKMEN

Trade Disputes and Remuneration Rates.—Without attempting to enter into controversial matters, it may safely be asserted that most industrial disputes are disputes as to rates of pay, which arise either because the employer is seeking to reduce wages, or because he declines to increase them. The principles underlying all schemes for the remuneration of workmen are, of course, the same as those underlying schemes for the remuneration of other employees, already dealt with in the preceding chapter, save that with workmen in particular is it impracticable to regulate the rate of pay entirely by the employer's rate of profit; indeed, the general tendency seems to be altogether in favour of a fixed rate of pay under all circumstances. A fixed rate will, however, almost always be an unfair rate—sometimes unfair to employer, sometimes to employed—and a rate fluctuating within narrow limits will be only one degree less so. Consequently it is hardly surprising that the relations between employer and workmen usually leave much to be desired in the interests of efficiency. With a view to avoiding these recurring disputes various schemes of

graduated remuneration have been attempted from time to time with varying success.

Piecework.—The crudest form, of course, is payment by Piecework, that is to say, remuneration based entirely upon the actual work performed. Upon the face of it that seems, perhaps, a reasonable arrangement ; but the trouble is—or seems to be—that as one goes on one sometimes gets to know so very much more about the subject than one did before, that an arrangement, which at first appeared to be entirely reasonable, may subsequently seem to be the very reverse. As a case in point, reference may be made to a certain work which it was desired should be proceeded with with all possible speed. The men were being paid by the hour, and progress was not satisfactory. Owing to the peculiar conditions work could only be pursued for a certain number of hours per day, and therefore it was not possible to economise time by working continuously in three eight-hour shifts, as might otherwise have been done. With a view to pushing the work forward, an arrangement was made that certain specified units of work should be paid for at so much per unit, and the employers started by thinking that they had made a very good bargain for themselves, in that under the piecework system they were only going to pay three-quarters the time price per unit, as, assuming three units could be done in a day, they were only to pay a quarter of a day's pay for one unit. The first day after this arrangement was put into effect the average number of units per man was five, in the second day it was a fraction over seven, and within a week some men were doing as much as eleven. At that time the word was sent down

from headquarters to stop the arrangement, headquarters doubtless thinking that it was ridiculous that such rates of pay should under any circumstances be employed. While *primâ facie* there may seem to be advantages in making workmen's remuneration dependent upon the quantity of the output (assuming, of course, that it is of the required standard of quality, and assuming that the standard of quality is capable of being readily verified), it would appear that the possibilities of increased output, as a result of increased exertion, are very often so great as to defeat the intended object. The employer undoubtedly benefits, in that he is probably paying a slightly lower rate per unit, and is getting his work done very much more quickly—which tends greatly to reduce standing expenses, and to save considerable sums in interest; but if he finds that the employees are benefiting by the arrangement to a far greater extent than he expected, instead of being content with his bargain, it is, perhaps, not altogether unreasonable for him sometimes to take the view that he was swindled while he was paying by time rates, and that he ought now to be entitled to revise the rates for piecework. At all events, in a great number of cases this practice is found not to work, either because employers are not willing to continue the piecework rates permanently, or because—possibly arising out of past experience—the workers, doubting the permanence of the arrangement, do not feel much incentive to try their best to increase the output.

Of course, increase of output is not necessarily the difference between working as slowly as possible and working as quickly as possible. It may in many cases

include the adoption of improved methods; sometimes improved and quicker working machinery; sometimes different methods of handling. Anything which will go towards increasing the speed with which an article can be constructed, even at the same rate of pay, is clearly to the advantage of the employer; but if the economy in speed is very great indeed, it may well be that the employer considers that he is entitled to some additional advantage. At all events, whatever the merits of the case may be, that is a point upon which disputes frequently arise, and the risk seems to be that employers may thus find themselves working counter to the goal that they ought always to aim at—*i.e.* not an immediate advantage, but a permanent advantage, so that their business may be one steadily developing itself, over an indefinite number of years if necessary, rather than one capable of producing marvellous results—financial or otherwise—for only a limited period of time.

It is now proposed to describe four different methods that have been tried, more or less experimentally, with a view to arranging some means of remunerating workers that will prove more practicable than the crude system of piecework, which experience seems to have shown is apt to prove non-permanent, by reason of the somewhat unexpected results it often produces, which represent a far heavier payment to the workers than is thought to be equitable under all the circumstances. These four methods are described as (1) the Differential Rate Plan, (2) the Time Shared Plan, (3) the Progressive Rate Plan, (4) the Reference Rate Plan, respectively.

Differential Rates.—Taking first the Differential Rate,

under this method the wages price per unit of work increases with the number of units turned out in a stated time. It is, therefore, in one sense, more crude than the plain Piecework system, because, not being content to pay the worker at a stated rate per unit, it pays him at an increasing rate as his speed increases. From the point of view of the employer this may be remunerative in certain cases, on account of the enormous economy in standing expenses in cases where work is done with the greatest possible expedition, quite apart from the important question of the saving of interest on capital, already referred to. It is therefore best suited to—and probably only suited to—cases where the amount of capital involved is very considerable, and the standing expenses are relatively high. It has been tried in steel works in Philadelphia. The first step is to fix what the deviser of this system describes as "elementary rates." To do this the time required for each kind of operation is carefully gone into, and a record kept of the results. Any object for which a price is wanted is subsequently divided up into so many "elementary operations," which may be called units. The standard time for each of these units is obtainable from the records, and in that way it is an easy matter to ascertain the total time that ought to be occupied upon the job. The Differential Rate is thus applied in the form of a high price per unit if the work is satisfactorily completed in the shortest possible time, and lower prices if longer times are taken; provision being made that, if there is anything wrong with the quality of the work, the operator is disqualified from securing the highest rate. Suppose, for instance, the usual output of a worker in a week of 54 hours

would be 27 units at 1*s.*, it would be £1 7*s.* per week for the operator. If an analysis of these elementary operations showed that, as a matter of experience, it has been found that 36 units of work could be turned out within the week, and that that is the maximum number that ever has been, the price (subject to 36 being completed in the week) might be put at 1*s.* 1*d.* per unit, thus giving the worker, in addition to the extra remuneration upon the nine additional units, an inducement of 1*d.* per unit on the whole number to produce the maximum possible. In such a case the increase in the total cost of Wages would be 33⅓ per cent. If the corresponding Standing Charges (including interest) were equal to the Wages—that is to say, at the rate of £1 7*s.* per week —they would work out on the larger output in the proportion of 27 to 36; that is to say, instead of being 1*s.* per unit, the Standing Charges would be 9*d.* per unit. There would thus be a gain to the employer of 3*d.* per unit in Standing Charges on giving an increase of 1*d.* per unit in the Wages, so that he would still have a net gain of 2*d.* per unit. Or, if the premium were fixed at 2*d.* per unit, he would still gain to the extent of 1*d.* per unit. In exceptional cases it might even be to the advantage of the employer to make the premium 3*d.*, as representing the whole of the saving, as in that way a greater output could be produced, which might avoid an enlargement of premises or the purchase of additional machinery, which would otherwise be necessary to cope with orders in hand. But unless the Standing Charges are unusually high in proportion to the Wages paid, it is not often that this arrangement would work out to the advantage of the employer.

"**Time Shared**" **Rates.**—With regard to the Time Shared Plan, the idea here is to divide between the employer and the workman the value of the time "saved." This method has been tested in Canada. First of all, a time standard is fixed for every operation, or unit, which of course must be fixed by prior experience; but whatever time the workman may actually take is paid for at the ordinary rate per hour. If the work is completed in less than the standard time, the worker receives as a premium a specified amount per hour saved; that is to say, he gets 25 per cent. or 50 per cent., or some other agreed percentage, of the saving of time due to his speed. Thus, if the time allowed be twelve hours, and a worker is paid 6*d.* per hour, a reduction of the time to ten hours is a saving of two hours. If the worker get 50 per cent. on the time saved, he will get 5*s.* for his 10 hours' work, and in addition he gets half the time saved (2 hours @ 6*d.* per hour = 1*s.*), that is 6*d.*; so that in that case he would actually receive 5*s.* 6*d.* for 10 hours' work, instead of the ordinary time pay, which would have been 5*s.* for the 10 hours' work. The employer gets the work at a cost of 5*s.* 6*d.* instead of paying 6*s.*, and he has also the advantage of getting it done more quickly. In the event of the work being done in half the standard time—that is to say, in 6 hours—the workman would receive 6 hours' ordinary pay, which would be 3*s.*, plus one-half of the 6 hours saved at 6*d.* per hour, which would be 1*s.* 6*d.*; making a total payment of 4*s.* 6*d.* for the 6 hours' work, which would work out at 9*d.* per hour, instead of 6*d.* per hour. The employer thus gets an increased advantage corresponding to each advance in the worker's pay, quite apart

from the indirect advantage of being able to turn out more work with the same standard equipment. Thus, if a worker is working so fast that he gets 9*d.* an hour instead of 6*d.*, for 40*s.* 6*d.* expended in wages (reckoning 54 hours to the week) there is an output in that one week which would have occupied two weeks at a cost of 45*s.* under the ordinary day work system at 6*d.* per hour. But such an increase in the weekly pay of the worker, or the greater increase under a still further reduction in the time, would seem unreasonable to many employers. They would probably feel either that the time allowance or the premium was unduly high, and such an impression would probably interfere, as in the case of piece work rates, with a continuance of the system as a permanent institution. It is especially desirable, therefore, if this plan is to be followed, to consider very carefully beforehand both the time allowance and the premium, and there should be accurate data as a result of past experience upon which to base one's estimates; for if there is any likelihood of exceptional wages leading to a requirement on the part of the employer to modify the terms, naturally the workers will be tempted to restrain their energy, and then, of course, the whole object of the idea is frustrated. It would seem desirable, therefore, at all events in the first instance, and until ample data are available, to start with a moderate premium and a liberal time allowance.

"Progressive" Rates.—The third method, or Progressive Rate Plan, has been tried successfully in Glasgow and elsewhere. The distinctive feature of this system is that it minimises the wide fluctuations in the rate of pay that is apt to be brought about by the Premium

System and the Time Shared System. The premium is given in the form of an increase in the rate of pay, such increase being in the same proportion to the ordinary rate of pay as the time saved is to the standard time ; that is to say, in effect the employer says to his workers, "Reduce the time by 10 per cent. or 20 per cent., or whatever it may be, and I will increase your rate of pay by a similar percentage." For facility of comparison, we will take again the case of a certain unit of work done under ordinary day-work conditions in 12 hours, at 6*d.* per hour, and assuming 12 hours to be adopted as the standard time; then, under the Progressive Rate, if the workman reduces this by 2 hours, or by one-sixth, his pay for the 10 hours that he does work is increased by one-sixth, and is therefore 7*d.* per hour instead of 6*d.* per hour, so that he will get 5*s.* 10*d.* for the 10 hours' work, as against 5*s.* for 10 hours' work at ordinary rates. Similarly, if the time occupied can be reduced to 6 hours from the standard time, the rate per hour works out at 9*d.*, that is to say 6*d.* per hour plus one-half of 6*d.*, because half the time has been saved ; so that for the unit of work in that case he would get 4*s.* 6*d.*, instead of 3*s.* under the old rates. In the one case the employer gets his unit of work for 5*s.* 10*d.* ; in the other for 4*s.* 6*d.*, as against 6*s.* under the day-work method. He therefore gets a substantial advantage, even apart from the saving in Standing Expenses and interest on capital outlay. It is not likely that one would be able to effect a greater reduction than one-half, assuming that one had reasonable data to go upon before fixing one's standard; but, to show how the plan would work out in extreme cases, suppose that the

unit of work could actually be completed in one hour. Then the worker would receive $11\frac{1}{2}d.$ per hour, that is to say 6*d.*, the standard rate, plus eleven-twelfths of the standard time which had been saved. This would work out at £2 11*s.* 9*d.* per week for 54 hours, as against £1 7*s.* per week for day work, and it could compare with £8 15*s.* 6*d.* per week, if the same results were produced under the Time-shared plan with a 50 per cent. premium. Even if there are great mistakes in the original data, the progressive rate plan does not produce extravagant results in the pay to be awarded to the worker. If there should be errors in the estimate of standard time for the unit—as is almost certain to be the case, at all events when a system of this kind is first introduced, when probably there are no reliable *data* already tabulated—the results would not be so fatal to a continuation of the experiment as the results under the Time Shared Plan would be. The Progressive Rate thus seems much more suitable under normal circumstances, for it need hardly be pointed out that unless there is some reasonable assurance that the experiment will be persisted in, there is but little encouragement to the worker really to apply himself so as to produce the best possible results. He would naturally be somewhat suspicious that the experiment was being conducted, possibly at a loss for the moment, with the object of ultimately reverting to the former lines, but with an excuse for squeezing a much greater quantity of work per week out of the worker for the same, or a very slightly increased, remuneration.

It is important to bear in mind, of course, that these economies in the time occupied per unit may be, and

probably in most cases will be, due to many other causes besides increased energy on the part of the worker. Experience seems to show that when it is made worth his while it is quite practicable for the worker to produce units of work much more rapidly than he normally does when paid a uniform rate per hour; but that after all is by no means the only point to consider. A practical question that is continually arising in factories is, where new machines come into use for performing old operations; particularly if some form of piecework has been employed in the past, there may be much discussion as to what the rates of pay should be for work with the new tools, or the new machines. A system which will provide a reasonable prospect of a permanent settlement of these points, while yet providing a substantial advantage to the worker as a result of the improved methods of work, is one which it seems to be best calculated to produce the most satisfactory result, quite apart from the great importance of expedition for its own sake—not merely as enabling a larger output to be handled in times of pressure, but also as enabling a larger output to be handled normally without increase of working capital.

"Reference" Rates.—And lastly there is the Reference Rate Plan. Under this method a wages limit, or reference rate, is fixed for a given unit of work, and if the worker completes this quantity in such a time that his daily wages amount to less than the reference rate, he is paid his share of the saving. Thus a worker at 6*d.* per hour, by the reference rate of 6*s.* and a 50 per cent. share of the saving, gets the same results as under the time-shared 50 per cent. plan with a time limit of 12

hours at 6*d.* per hour. If 2 hours are saved, he receives 5*s.* for the 10 hours, plus one-half of the difference between 5*s.* and 6*s.*, which makes a total of 5*s.* 6*d.*; but the reference rate gives a wider margin to a lower paid workman where all men are not paid the same rates. Under the time-shared plan a slow workman at 5*d.* per hour might get very little out of a 12 hours' standard time, and if he makes no reduction of the standard his pay would not exceed 5*s.* With a reference rate of 6*s.*, the completion of his job in 12 hours gives him a premium of 6*d.*, being half the difference between his time wages for the 12 hours and the reference rate, and thus his total pay would be 5*s.* 6*d.*, although he had not effected a saving in time. So far as the 5*d.* per hour man is concerned, the 6*s.* reference rate is really equivalent to fixing for him the standard time at 14⅓ hours, and if he can produce his work in less than that 14⅓ hours, he gets a proportionate advantage which he would not have got under the time-shared system. This plan, therefore, has the advantage that it automatically varies the time limit according to the pay of the worker, which (presumably) is to say it varies it according to the worker's actual capacity. It is particularly suitable, therefore, to business houses where apprentices and improvers are employed at the rates lower than those paid to skilled workers, as it provides a plan for inducing these to do their best to expedite matters in exactly the same way as it affords an inducement to the experienced worker. So, as a matter of fact, does it seem to work out in practice; but, of course, it is not in every factory that varying rates of pay exist; where there are no varying rates the plan would seem to possess no

features that the time-shared plan is not able to provide.

Summary.—To sum up, then, before any permanent system is introduced, it would appear to be very important to have a careful collection of data bearing upon the time required for each separate operation, or unit of work, from time to time required to be performed. Such an arrangement can therefore hardly be inaugurated successfully in any works without some preliminary experiment, because almost certainly the required data would not be in existence unless they had been built up more or less for this particular purpose.

Gangs of Workers.—When several men work on one job, a time allowance can be fixed for the whole, and any premium earned by the gang can be shared in the proportions borne by these men's time wages *inter se.* There would always, however, be certain extraordinary matters for which allowance would have to be made. For instance, if a man attends to more than one machine, some margin must probably be allowed for time lost by his attention being diverted. Similarly, if with one or more machines he has the assistance of an apprentice, or an improver, a part only of the assistant's time should be charged against the time limit. These are points which would probably increase the difficulty of applying the system to any works in practice. They do not seem to be points representing difficulties that cannot be overcome, however, if there is any real desire on the part of both masters and men to combine together in producing their work as expeditiously as possible for their mutual advantage.

Application to other Classes of Workers.—The methods

described relate, it will be observed, solely to work done by men of the artisan class, and it is, of course, in connection with this class of work that problems in connection with remuneration are most likely to be of serious importance, as involving the most considerable sums; but an inquiry into the various plans suggests that something less crude than a mere commission might often be employed with advantage as a basis of the remuneration, or part remuneration, for many other kinds of work. Instead of having a fixed rate of commission, no matter what the result may be, a commission upon some sort of sliding scale, dependent upon circumstances more or less within the control of the individual worker, would probably produce the best result in the long run; and it might further possess this somewhat important advantage, that if only a really satisfactory basis could be framed upon these lines, it might solve once for all the difficult question of considering upon what conditions advances in rates of pay shall be made. Too often length of service is the principal, if not the only, factor in determining rates of pay; whereas clearly, from the point of view of the employer, it is at best only one of several factors. Length of service must, of course, be considered, because the employer aims at building up a permanent staff of workers, thus avoiding the inconveniences and disadvantages of continual changes; but that, after all, is not the only point. He will want, as far as possible, to increase efficiency without necessarily being bound to wait for the experience that length of service may well be supposed to give as producing efficiency. Experience is but one point out of several; and if remuneration is

based upon that alone, the other points are apt to be overlooked, or, at all events, to be insufficiently considered and insufficiently recognised. The last-named is perhaps even more important, for effort that is unrecognised is, of course, not likely to be continued, except by the man who does not look upon his present position as permanent, but regards it merely as an opportunity of increasing his value, so that when he goes somewhere else he would receive a more suitable recognition for the work that he is able to perform. That clearly is a frame of mind that one does not wish to encourage, because it is directly contrary to the ideal of building up a permanent staff, upon such lines that, as time goes on, that staff may become more and more efficient.

CHAPTER VIII

THE "INTELLIGENCE DEPARTMENT"

The Need for Specialising.—It is now proposed to offer a few suggestions upon what, for want of a better name, is called the "Intelligence Department" of a business—its nervous system, so to speak—by the aid of which it gets into touch with the outside world, and gets to know of possible dangers and receives information that it can turn to its advantage generally with the aid of such intelligence. The term "Intelligence Department" is, however, perhaps not altogether a happy one to employ, as it suggests that a certain definite portion of the staff is set aside for the performance of these duties; whereas in practice it would only seem possible to specialise in the direction of the intelligence department within somewhat narrow limitations. For certain purposes one may thus specialise with advantage no doubt; but the higher and more important functions of the Intelligence Department must, in the great majority of cases—if not in all cases—be performed chiefly by responsible managers and by those immediately under them. What one has to aim at here is, in the first instance, some sort of systematic connection between the "brains" of the whole of the organisation, so that the knowledge possessed by certain members of the staff is available for the benefit of all

whom it may concern; also to some extent one requires to supplement that by mechanical means—that is to say, by records which will aid the memory of those who are already acquainted with the facts, and serve to distribute knowledge among those not already acquainted with the facts, with a minimum loss of time and a minimum amount of labour.

"Follow-up" Systems.—As being the simplest and most straightforward part of the subject, inquiry may first be directed to the mechanical means available to enable one to connect together records and results, so that the experience to be derived from these results may be placed upon record and made generally available. Perhaps the simplest form of device here, and also the most effective so far as it goes, is one of those adaptations of the Card System that are generally known as "follow-up systems." It is not necessary to explain them in detail here, as those who are interested can readily obtain the necessary particulars upon applying to any of those manufacturers who deal in card systems; but it may be pointed out that the idea seems to be applicable to the systematic record of inquiries and orders, and also to advertising. In connection with inquiries, a definite form of "follow-up system" will save much trouble, by enabling this class of work to be codified to a large extent, without repeating the same information to the same inquirers, who, as a matter of fact, may be asking for something more detailed than the information already provided. In suitable cases it may be desirable to follow up these inquiries by a personal call: in other cases one may follow them up by written communications, in the hope that they will eventually crystallise into

orders. It is very desirable, however, to point out that it is quite easy to overdo system in such matters, and that anything of this kind requires to be carried out with a certain amount of tact, if the best results are to be produced. There is certainly no harm done by following up inquiries to a reasonable extent. There is no harm in inquiring why orders have ceased to come in, or are coming in for smaller quantities than before; but no very useful purpose is likely to be served by worrying people, particularly at the wrong time. Consequently, just because these follow-up systems have been perfected mechanically, it would be a great mistake to suppose that they are of so self-acting a nature that they may be put into operation by quite junior members of the staff, who have little or no experience in such matters, and may easily create quite the wrong impression.

Advertising Results.—As applied to advertisements, there can be no doubt of the value of any kind of system that helps to connect expenditure and results; that is to say, to show the actual benefit derived by the undertaking from each separate advertisement. At the same time there will always be considerable difficulty in really determining what precise advertisement actually produced any given order when advertisements are at all upon a large scale, for the probability is that the customer, before giving any order at all, has seen advertisements in several different newspapers, periodicals, or other forms of publication; and it would be difficult indeed in such cases to say precisely which of these actually produced the result. Various devices have been attempted with a view to connecting orders with advertisements. One of the simplest is to attach to

the advertisement a request that all inquiries be directed to a department indicated by a letter, or number; the letter, or number, not corresponding with any department having any real existence, but being designed merely to identify the precise advertisement whence the inquiry proceeded. But probably only the minority of inquirers will take the trouble to follow out these directions and fix the desired departmental letter or number, and it is questionable whether any very reliable conclusions can be drawn from the limited number of cases where these instructions are conforrned to. Another device, primarily instituted with the same object, has been to start competitions of some kind for which prizes are awarded, a slightly different form of competition being announced in each separate newspaper or periodical. In this way, of course, it is quite practicable to identify the results with the source which inspired the application; but in the nature of things it can only be to a very limited class of concerns that the competition idea is likely to appeal as being productive of satisfactory results. But, unsatisfactory as all such records must necessarily be, for what it is worth, and for want of anything better, there can be little doubt that some form of systematic record of advertisements upon the card system will probably prove of value to those responsible for the distribution of advertisements. At all events they will not be time entirely wasted, as they will prove of considerable use when checking demands for the payment of advertisements at a later stage, and the same records can quite conveniently serve the double purpose.

Accounting Records.—Other forms of mechanical

records for the information of the Intelligence Department come perhaps rather under the heading of accounting than of business organisation, but for the sake of completeness they may be mentioned in passing. In connection with every manufacturing concern statements of the manufacturing cost of the various articles made, or of contracts completed, are required not merely for the information of departmental managers, but also of those in supreme control; and, in the nature of things, if they are to serve any really useful purpose, they must be prepared promptly—to serve as "news," rather than as "historical records." Similarly with regard to the question of finance, those responsible for the financial side of any business concern will require to be kept continually informed as to the state of its finances, both in respect of working capital and of fixed capital, or capital expenditure. As regards Working Capital, it is obvious that without prompt information as to what money is coming in, what money may be expected to come in in the near future, what accounts call for immediate payment, and what further accounts will require to be paid in the near future—without reliable returns upon these points it is obvious that finance can never be systematic, but must proceed upon pure guess-work. But apart from that, inasmuch as most undertakings are progressive, if successful; and, if progressive, almost invariably require a more or less continual extension of equipment, further financial statements become necessary, condensing into a practical form the requirements of practical managers in the way of extensions, and the dates by which it is desirable that those requirements should be provided, together with estimates of the

necessary cost. Of course it goes without saying that many of these items of information will already appear in the books of account, if proper books are being kept. At all events, in theory that would be the case; but in practice books of account are not always kept so closely up to date as to give the desired information upon all points as soon as it is necessary to have it. In any event, it would probably have to be ascertained from the books of account by searching for it, instead of being already in the condensed form in which it is required for this particular purpose; and, moreover, so far as these returns relate to the future, in the nature of things it is not always possible that the desired information should already be recorded in the books. At the same time there should be a definite connection between Returns of this description and the books of account, and the Accounts Department might well be held responsible for the information provided by both corresponding. It is particularly important, however, that, so far as the information required for these Returns is based upon records of transactions appearing in the books of account, these Returns should not be compiled by those members of the staff actually responsible for the state of affairs there disclosed. Thus to mention a very few instances, collectors and cashiers do not represent a suitable source for inquiring as to the receipt of outstanding book debts; and those responsible for incurring expenditure should in like manner not be expected to compile Returns showing expenditure up to date—otherwise there is naturally a strong temptation to suppress, or to modify, these Returns, if the results that they show indicate irregularities or extravagance.

A "Clearing House of Brains."—Turning from these more obvious matters, where it is possible to organise the Intelligence Department upon some definite system of record, the next step seems to be to inquire how far it is practicable to arrange matters that one may have, so to speak, a "Clearing House of Brains," so that the information communicated to any member of the staff may be generally available, without special inquiry being necessary in the first instance. One wants, if possible, to establish some sort of system equivalent to the nervous system of some living animal—by which, directly there is anything like a highly organised state of existence, it is impossible for anything to happen to any portion of the body without the whole of the body being at once made acquainted with the fact. One wants also to put one's self into such a position that outside facts that are of interest to one may come to one's knowledge at the earliest possible moment.

New Legislation.—For instance, it is clear that, if any new legislation is passed, or any new regulation is made by some governing body affecting our industry, whether at home or abroad, it is of vital importance that we should be made acquainted with the facts at the earliest possible moment. One of the most common sources of information of this description is the trade papers—the newspapers catering for particular forms of industries—which make it their business, as far as possible, to collect all information likely to prove of interest to their respective readers. Whether, however, that is the most perfect form of intelligence department in these matters is perhaps another question. The answer doubtless depends upon the degree of efficiency with which one

is content. One would doubtless, in that way, get early information with regard to home legislation; but it is by no means equally certain that one's knowledge of what is going on abroad—or about to go on abroad—would be equally prompt. For such purposes Local Agents are practically essential; and if the services of local agents who are in touch with the legislature of foreign countries be secured, doubtless one will get earlier information than would otherwise be likely—and it need hardly be added that, as a rule, it is the man who gets the earliest information of a pending change that is able to make the most profitable use of his knowledge.

New Markets.—The same remark, of course, applies to new markets. Unless, owing to the nature of the business, one is limited in one's activities in the way that (say) a gas, or water, or electric lighting undertaking is necessarily limited, one of the most important features in connection with successful development is undoubtedly that portion of the Intelligence Department which discovers the demands continually growing up in foreign countries, and dependencies abroad, for the articles that one is in a position to supply; and here, again, it is the man who has the earliest information that is able to make the most use of it. This remark applies, of course, both with regard to buying and selling, and it would be difficult to say in connection with which it is of the most importance.

New Inventions.—Another point that is perhaps not sufficiently considered in many cases is the vital importance of keeping in close touch with new inventions. Naturally the precise importance to be attached to this

point will depend a great deal upon the form of business undertaken ; but in almost every case there will be possibilities of lessening the cost of production—or of increasing the efficiency of the article, or service, that one is in a position to offer—as a result of new inventions, and the fact that the vast majority of these inventions will doubtless prove entirely valueless, and the time spent upon inquiring into them a sheer waste of time, ought not to blind one to the fact that, with regard to those new inventions that do turn out to be commercial successes, the importance of being the first in the field to acquire the use—or even the exclusive use—of the patents can hardly be over-estimated.

The "Open Door."—Here, probably, the American system of the "open door" of the chief responsible manager of the business presents considerable practical advantages, as compared with the customary British method, where the managing director (or chairman) fortifies himself behind closed doors, and receives no communication from the outside world, save through subordinates of his own choosing. The result of that arrangement must necessarily be that the duty of deciding what is important, and what is negligible, rests primarily upon those in a comparatively subordinate position ; and it may well be doubted whether that is the right way round for the arrangement to be. A much better plan would, in all cases, seem to be for the supreme Head first to get into touch with all these matters, and afterwards to depute his subordinates to make such inquiries as he may think fit, and to report the results to him for further consideration. In the nature of things his time would be too valuable, and too occupied, for him to

make all the necessary inquiries personally; but that is no reason why he should not at least have some general knowledge of the inquiries that are being made, and direct them so far as may seem necessary for the production of good results.

Complaints.—Another point conveniently dealt with under this heading is the proper treatment of Complaints. Complaints will always occur, even in the best managed businesses. Sometimes they may be unfounded; sometimes, on the other hand, they may be only too well founded. But, in either event, it is of surpreme importance that every system of organisation should be so framed that all complaints may be dealt with as far as possible by the supreme Head, or by persons in high authority specially authorised for that purpose. The most fatal thing to the permanent reputation of any business is an arrangement under which subordinates who have made mistakes are allowed to do their best afterwards to put things straight. Even supposing they should be able to remove the cause of complaint for the time being, such a state of affairs is highly undesirable, in that it means the existence of the cause of complaint does not come to the knowledge of those in supreme authority. By losing touch with this branch of the business they are losing one of their best opportunities of keeping acquainted with the efficiency with which their subordinates do their work. Complaints are of varying kinds, but whatever their source may be these remarks seem to apply. Whether the complaints come from customers, from those who supply goods and consider that they have been badly treated, from agents, or from members of the staff—in any event they may be most

effectively dealt with by those who have at least no interest in concealing the facts, if in point of fact the complaints be well founded. And in many cases, even where the complaints are unreasonable, it is not always expedient to contest the point. A concession quickly made often increases the value of the connection; whereas delay in dealing with a point in a way that is thought to be adequate, even if the right be upon one's side, is apt to produce a bad impression which is perhaps never altogether eradicated. Again, where disputes arise, and they are not promptly and amicably settled, they will almost invariably lead to loss of that particular connection, or to litigation, or possibly to both. Litigation, even if successful, is rarely a thing to be desired; and indeed we may take it that no really prudent business man would ever embark upon litigation, save in cases where there is some definite principle involved, and he knows that if he once gives way the result will be fatal to his future success, because he will be expected to give way in the same direction time after time hereafter.

The most trivial complaints may easily develop into serious difficulties; hence the importance of arranging matters so that they may at once come to the knowledge of headquarters, and there be dealt with, as matters of high policy, upon whatever lines may be thought most desirable in the permanent interests of the undertaking. There is also this to be borne in mind, as a further reason for so centralising the Complaints Department, that the proper and most successful treatment of this question—like the treatment of all other matters—is largely a matter of practice. Any one can make mistakes—any one may give cause for complaint; but it is certainly

not every one who can remove the cause of the complaint, or correct mistakes, the first time that he attempts to do so. It is infinitely more likely that he will make the position worse, instead of better. Those, on the other hand, who are in the habit of dealing with such matters are able to bring their experience to bear upon them; settle them without any of the time and trouble that the inexperienced would require to devote to the matter, and settle them much more satisfactorily to both parties —and unless both parties are satisfied the settlement will not really be satisfactory to either.

Organisation and "Grooves."—A great deal is sometimes said upon the subject of "getting into grooves," and in the way that the expression is often used the implied complaint is, no doubt, justified, in that it often means that men get into the habit of doing certain things without really thinking what they are doing—with the result that, sooner or later, they will probably do something wrong, because they have been unable to appreciate the fact that they are dealing with an exceptional case requiring exceptional treatment. But although this unintelligent kind of getting into grooves is therefore to be deprecated, it should be borne in mind that every process of organising or systematising anything is a process of deliberately making grooves—of, so to speak, laying down tramlines in order to be able to increase the speed of transit. It is a process of arranging modes of communication upon lines which have been found necessary as a result of experience; and if we are to profit by our experience, these lines will add greatly to the efficiency with which we shall be able to conduct our business. Every form of habit

results in mental grooves. The question, therefore, about grooves largely depends upon whether they are the result of good or bad habits. If they are the result of bad habits, then everything that can be said against getting into grooves can be justified; if, on the other hand, they are in the direction of organising work and doing everything systematically, then the groove will be the result of well-directed effort, and will remain to show that past experience has not been wasted. The point of this application of "grooves" to the question of complaints comes in in this way. The man who is in the habit of dealing with complaints (and in a large business the number of complaints must always be considerable), like the man who is in the habit of dealing with any other class of work, can deal with the simpler forms almost unconsciously. Instead of having to wade laboriously through the pros and cons of each separate case, he will find that these complaints almost automatically sort themselves out into different classes, and that they call for treatment according to this classification. Thus, with a very little expenditure of personal time, he is able to give instructions which will result in the matter being settled in the most satisfactory manner with a minimum amount of friction to all parties concerned, and with a maximum amount of expedition. The wise handling of complaints may even be turned to good account sometimes, as consolidating and increasing connections; whereas the tactless handling of the subject is necessarily bound to injure the reputation of the concern and to damage its future prospects, even should those complaints prove to be entirely unfounded. Hence it would seem that a strong case has been made out in

favour of specialising in the Complaints Department, with a view to increasing the efficiency with which this work is handled, and also with a view to enabling those in command to become acquainted as speedily as possible with all mistakes that have been made, whether or not those mistakes represent faults on the part of employees that ought to be taken note of in the interests of proper discipline.

CHAPTER IX

STOCK EXCHANGE PRACTICE

The Function of Exchanges.—When considering the machinery that exists for the purpose of facilitating the conduct of business, one naturally turns one's attention first to Stock Exchange practice, not so much because it is very closely identified with the majority of business concerns, as because to some extent questions of Stock Exchange practice arise almost invariably with all business houses, no matter what their precise occupation may be. The Stock Exchange may also be taken in some respects as being a type of Exchanges generally, in that the essence of the idea is that those who may desire to do business in certain specified commodities shall have opportunities of meeting together so that they may ascertain one another's wants, and as far as possible pair their respective wants against each other to their mutual advantage. It is, of course, not absolutely essential that dealings in stocks and shares should take place on the Stock Exchange, and the stocks of certain companies are in point of fact not dealt in there at all; but, in the absence of an exchange, it becomes necessary for every would-be seller and every would-be buyer to find out for themselves where, and with whom, they can effect a deal. A great deal of time and trouble

is thus necessarily wasted, with no corresponding advantage, except that under these circumstances buyer and seller come into direct communication with each other, and therefore may save the expense of the middleman. If the expenses of the middleman were a serious item, there might be a great deal to be said in favour of buyers themselves looking out for sellers, and sellers themselves looking out for buyers, in order to avoid this expense; but inasmuch as the middleman's charges are really very small indeed, it is actually to the advantage of both buyers and sellers that these Exchanges should exist. Indeed, they would not exist if they did not daily prove themselves to be to the public advantage.

The London Stock Exchange.—It is not necessary for our present purpose to go closely into the history of the origin of these Exchanges, but it is desirable perhaps to say something concerning their constitution. The London Stock Exchange is undoubtedly the most important Stock Exchange in the world, and will therefore be taken first. It has no monopoly, and is not in any sense of the term a public, or official, body. It is for all practical purposes a Club. The buildings and property are owned by certain, but not by all, of the members of that Club. The Club is managed by a Committee, and it possesses the somewhat unusual feature that all members have to be re-elected annually. It is difficult to imagine any more efficient method of compelling conformance with a high standard of upright dealing. With other bodies—such, for instance, as Solicitors, Barristers, Chartered Accountants, and the like—the controlling body has the power, within varying limits, of expelling

members for proved misconduct; but the power of expulsion at best moves slowly—that is to say, one has to wait for proof—and in many ways is not altogether as satisfactory as might be wished. It is notorious that in almost all these professions there are certain persons who, by common consent, ought, in the interests of the public, not to be allowed to continue in practice. So far as the members of the London Stock Exchange are concerned, the difficulty in such cases is very readily got over by the fact that members have to be re-elected annually. If there is any general impression that a member has been guilty of undesirable conduct, even if it be not of such a flagrant character as to merit expulsion, there is a risk—and it is a genuine risk—that he will not be re-elected; and the result of that is that the strongest possible motive is given to members not to attempt to "sail too closely to the wind." They have not merely to keep on the right side of the law—they have further to maintain a reasonably clean reputation. That is a rule which might, it is thought, with advantage be extended considerably—particularly in connection with callings where there is no monopoly granted, and where, therefore, the hardship arising from non-election is not so serious as if the individual were thereby prohibited from pursuing his calling altogether.

Settlement of Disputes.—The next point to which attention may usefully be directed is the manner in which the London Stock Exchange settles disputes. Bearing in mind the enormous volume of business transacted on the Stock Exchange, and the speed with which it is transacted, it will readily be understood that cases are by no means infrequent in which there is a genuine

difference of opinion as to what has been done, or ought to have been done. Orders are misinterpreted, or there is a difference of opinion as to the price at which an order is supposed to have been executed. All differences between members must be referred to the Committee. The Committee, if it thinks fit, will announce no decision of its own, but will leave the parties free to have recourse to the Law Courts to settle their differences; but there must be no litigation between members without this leave of the Committee. Such leave is in practice rarely given unless a really novel point of law is involved, or there is a serious doubt as to the facts. In the great majority of cases the Committee gives its decision; and it gives its decision "on the nail." That is to say, the disputants may be asked to retire for a few minutes while the members of the Committee talk matters over; but the decision is given practically at the time, so that the loser may be able to cover his loss as quickly as possible. The Committee never gives reasons for its decisions. To give reasons would clearly be to invite discussion on its findings. Where no reason is given, the effect is in practice that the decisions are accepted; that there is no subsequent bad feeling between the parties; and that each is free to pursue his business without having his attention diverted by pending litigation—and of course all the expenses of litigation are avoided. This also is a point where it would seem very desirable that other forms of business machinery should take a hint from the Stock Exchange practice, to their mutual advantage.

Provincial Stock Exchanges.—Provincial Stock Exchanges exist in most large towns. They are run upon

very similar lines, with local Committees, but the members of these provincial Stock Exchanges are not members of the London Stock Exchange, although to a very large extent they deal with members of the London Stock Exchange.

"Outside" Stockdealers.—There are also a great number of dealers and brokers who are members of no recognised Exchange, and are therefore commonly spoken of as "outside" stockbrokers, or "outside" stockdealers. No doubt many of these carry on *bonâ fide* businesses; but, being subject to no outside control, it is only natural that the least reputable members of the calling should be found among the ranks of these outsiders. It would seem that the only possible inducement for a man of substance and reputation to remain an outside broker is, that he thus is free from the very stringent rule of recognised stock exchanges which prohibits advertising on the part of members. An outside broker is free to advertise, and may therefore earn his living without having any established connection; whereas an inside broker depends entirely upon his own connection, and on the recommendations of his clients for its extension.

Brokers and Jobbers.—The London Stock Exchange differs from provincial Exchanges in that its members are divided into two classes, called respectively Brokers and Jobbers (or Dealers). Brokers act as agents for the public, to execute orders received from the public for the buying and selling of marketable securities. Under the rules of the House, as at present constituted, these orders must be executed with Jobbers. A Jobber, on the other hand, is a mere dealer (or merchant) in

marketable securities, and generally confines his attention to a limited number of these securities, with which he considers himself to be fairly well acquainted. He acts as principal—selling to the Broker, or buying from the Broker, as the case may be—and he is prohibited by the rules of the House from dealing with any one who is not a member. He may deal with another Jobber or a Broker, but with no member of the outside public. Until recently Jobbers used very frequently to deal direct with provincial Stock Exchanges, but the practice has now been prohibited.

The Transaction of Business "on Change."—The process of executing business "on Change" may be described shortly in this way: A Broker receives an order, let us say, to buy £1000 of a specified Stock, that will be £1000 nominal. He may, or may not, have a limit given him as to price. He proceeds to the Exchange, and inquires of a Jobber whom he knows, and who is in the habit of dealing in that particular stock, what is its price at the time. In making this inquiry he is careful not to disclose whether he wishes to buy or sell. The Jobber then quotes what is called a double price, say $86\frac{1}{4}$–$\frac{1}{2}$. That would mean that the Jobber is willing to buy at $86\frac{1}{4}$, or is willing to sell at $86\frac{1}{2}$. If the Jobber wishes to place any limit upon the quantity in which he will deal, he, before quoting a price, asks for how much stock he is making a price. He is then told the quantity that the Broker wishes to deal in, and of course if the quantity is very large it may affect the price. If the price is satisfactory, the broker closes at once by saying, "I buy £1000 So-and-so Stock at $86\frac{1}{2}$." Each party then makes the entry in his own pocket-book which he

carries about with him. If the price is unsatisfactory, without making any comment, the Broker will go on to another Jobber in the hope of getting a better price. He may find himself unable to do so, and may then go back to the first Jobber; but, of course, in the meantime the first Jobber may have altered his price. Now, it may, or may not, be the case that the Jobber, when he quotes a price for a thousand pounds of Stock is possessed of that Stock. It is largely a matter of chance whether or not he is possessed of the quantity; but if he is not possessed of the quantity of Stock that he is asked to quote for, he will quote a price somewhat higher than the price that he feels confident he can himself get the Stock for. The result is that if the Jobber is without the Stock—is what is called "short of stock"—the tendency will be for him to put up the higher of the two prices, and it is for that reason really that it may be advantageous for a Broker to go round the market and to compare prices. The prices do not represent the Jobber's opinion as to the intrinsic value of the Stock—they merely represent a price that he is prepared to quote because he feels convinced that he can do profitable business at that price. If he has a great deal of Stock on hand, he will try to encourage buyers by slightly lowering the price at which he is willing to sell. If he is very short of Stock he will try to encourage sellers by increasing the price at which he is willing to buy. Fluctuations in prices during the same day, when there is practically no alteration in the intrinsic merits of the Stock, may be regarded as being solely due to the question as to whether the Jobbers "on Change" are short of the Stock, or have plenty of

Stock on hand—and that, of course, is a matter that may be varying from hour to hour. In the case of a Stock which is not readily marketable—that is to say, a Stock in which there are likely to be very few dealings during the day—it is not uncommon for the Jobber to quote what is called a "wide" price; that is to say, a price with a very considerable difference in the buying and selling prices, say, for instance, 98–100—a difference of 2 per cent. That does not necessarily mean that he expects to do business at this price, but it may mean that he is not prepared to quote a closer price until he knows a little more what the Broker wants. In some cases he may altogether refuse to quote a closer price; but he may be willing to make a price to sell, or to buy, as may be desired, if it suits him. When that state of affairs exists, prices are said to be a matter of negotiation. Naturally the tendency in good times is for buying orders to be more frequent than selling orders. In such cases the Jobber has to be careful not to sell at such prices that he cannot afterwards cover himself. In bad times, on the other hand, selling orders will be more frequent than buying orders, and it may be very difficult for the Jobber to avoid purchasing a great deal of Stock that he would really very much sooner be without. His only alternative is, of course, to make his price so low that no one is willing to sell at that price; but that is very disadvantageous—particularly, of course, if the Jobber happens to be the owner of some of the Stock himself. In such cases it is not an altogether unheard of thing for Jobbers to find it convenient to be absent from the House altogether for some urgent reason. By being absent in times of panic

they can undoubtedly escape having a great deal of falling Stock placed upon them, which they could hardly refuse were they present, because the general feeling among Brokers not unnaturally is that, inasmuch as the Jobber does very well when prices are rising, it is only sportsmanlike for him to continue to make a business-like price when markets are falling; and a Jobber who consistently refused to make a price on falling markets would probably find that Brokers would prefer to do their business in good times with other Jobbers whom they regarded as "playing the game" better.

Checking Bargains.—Coming back to the question of actual machinery, it has been mentioned that both Jobber and Broker enter the bargain in their pocket-books; and here is to be found one of the most wonderful examples in existence of machinery working, one might almost say perfectly, with little or no business safeguards. Very largely it is a matter of mutual trust in each other's good faith. There is no time—it is not practicable—for Broker and Jobber to initial each other's books. The records are made from time to time throughout the day. These records are transcribed into the office books. The following morning the bargains are "checked," as it is called; that is to say, clerks from the Broker's offices call at the offices of the Jobber's for the sake of checking off the bargains between the two parties. Disputes are practically unknown, except in so far as mistakes are practically inseparable from the rapid conduct of business by human beings. It occasionally will happen that a Jobber has forgotten the name of the Broker for whom he executed an order, and has therefore been unable to book the name. Conversely

it may be that the Broker has booked the record against the name of the wrong Jobber. There may be some mistake as to price, or as to the number of Shares —or the quantity of Stock—dealt in ; but such mistakes are rare. The only mistakes in price that are ever likely to occur in practice are where the price is subject to wide fluctuations. The practice appears to be not to quote the full price, as stated above as $86\frac{1}{4}$–$\frac{1}{2}$, but to quote the fraction only, assuming that the other party knows what is called the "big figure." The quotation would, therefore, be "a quarter to a half." If there have been wide fluctuations during the past hour or so, it is just possible that the Broker might think the "big figure" was 85 or 87, and a mistake might arise in that way; but there is no difficulty, of course, in checking the figures where one is dealing with a Stock that is frequently dealt in, because there can be no serious doubt, directly one starts inquiring, as to what would be a fair price so far as the big figure is concerned at any particular time of day. Where mistakes do occur which cannot be explained away satisfactorily, the usual practice is to halve the difference. Failing that, the dispute is referred to the Committee, and the Committee gives its decision—as already stated—without attempting to give reasons. The decision might be that the bargain was for such-and-such a number of shares, at such-and-such a price, and it must be taken at that. That means, of course, that one party, or the other, will have to buy (or sell) a certain number of shares in order to be able to carry out the bargain, or in order to be able to get rid of the shares that he finds himself landed with, as the case may be. Whatever loss there may be on that transaction is a loss that he has to bear.

It seems safe to take it that there would be no profit, or there would have been no dispute. If there were a profit, the parties would perhaps agree to divide it. These mistakes, however they may be occasioned, are merely matters between members of the Stock Exchange; the public is entitled to have its bargains executed in accordance with its orders, and the Broker has to see that this is done. As between the Broker and the outside public, the execution of the order is recorded in a binding and legal manner by the Broker forwarding to his client a Contract Note, stating what he has done. What he has done is, of course, done as agent for his client; and therefore, as a matter of law, if the Jobber failed to fulfil his bargain, the Broker would not be liable. But, by an almost universal practice, Brokers do not shelter themselves behind the plea that because they are agents they are not liable; they invariably accept full responsibility, so far at all events as their means will enable them to do so.

Accounts.—All business transacted on the London Stock Exchange is settled at stated periodical intervals. The precise dates are fixed in advance by the Committee. Each period is called an "Account." At the close of the Account all transactions effected during that Account are closed off and paid for. But it is sometimes convenient to the client to postpone payment; and then, by arrangement with his Broker, he may get the transaction "carried over," as it is called. But it is a mistake to suppose that, when a transaction is "carried over" for a client, the settlement of the transaction itself is therefore postponed until a subsequent Account. So far as the Broker is concerned, he has to carry the transaction

through. What it really means is, that the Broker lends—or gets some one else to lend—a sufficient amount of money (or stock) to enable the deal to be carried through; and if his client is a buyer he is charged with what is called a Contango, which for all practical purposes is interest on the purchase-money. The rate varies according to circumstances.

Contangoes.—Persons lending money on Contangoes, as it is called, get a very good security: first of all, they get the actual stocks themselves; secondly, they get the personal liability of the broker; thirdly, they get the personal liability of the client. Therefore, lending money on Contangoes is an extremely profitable and safe form of lending money, and it is one of the classes of business which most Banks like to go in for—so long, of course, as it is conducted within reasonable limits; but, on the other hand, almost all Banks draw the line at lending money to carry over mining shares, because mining shares are subject to much wider fluctuations than most other securities.

Backwardation.—Sometimes a member of the public will sell Stocks or Shares that he is not possessed of. Then in order to effect a settlement he must either buy the same quantity of Shares during the same Account, when the two can be set against each other; or, failing that, he must get permission to "carry over" the transaction. Sales can be carried over in the same way as purchases—indeed, unless some sellers were willing to carry over, it would be rather difficult to arrange to allow purchasers to carry over—but the seller who carries over for his own benefit is also charged. He has then to pay what is called a Backwardation, which may be regarded

as being a fee, or fine, paid by him for failure to deliver the Stock which he agreed to deliver for the settlement on the account day. In exceptional cases a man may be in the position of a seller, and the number of persons desirous of taking up the Stock may be so few that it is a convenience to the market that the seller should be willing to carry over. In quite exceptional cases, therefore, a payment may be made instead of a backwardation being charged; and conversely, a buyer who is willing to accept postponement of the delivery of the Shares which he has purchased may sometimes receive a payment for the convenience that he has thus given, if Shares are very scarce. But under normal circumstances the public has to pay for the privilege of carrying over, whether it be as buyer or as seller.

Stock Exchange Clearing House.—The number of transactions taking place during an Account, even in quiet times, is very considerable, as may readily be gathered from the fact that there are something like 5,000 members of the London Stock Exchange, apart from 3,000 clerks, who are also members. Now, if all these had to effect a settlement of their dealings with each other direct, the operation would be an extremely lengthy one, and would probably occupy at least half of the whole time devoted to clerical work. It would be quite impracticable to carry out such a settlement in four days out of the fortnight, as is usually done. The difficulty is got over by establishing a Clearing House in connection with the Stock Exchange. At the commencement of the settlement, each member forwards to the Clearing House a statement of his commitments, of the Stocks that he has to hand over, specifying to whom they have to be handed,

and the Stocks he expects to receive, specifying from whom he expects to receive them. In the Clearing House these statements are sorted out and reduced to a minimum, and then a memorandum is issued to each member giving him directions to whom to deliver the Stocks that he has to deliver to some one, and intimating to him from whom he may expect to receive the Stocks that he expects to receive. He will probably receive them from members quite other than those with whom he did his original deals, but as far as possible the transactions are sorted out so as to place the ultimate buyer's Broker and the seller's Broker into direct communication, and to eliminate the intermediate dealings. In that way, an enormous amount of time is saved, the settlement can be carried through rapidly, and the result is that every one concerned is again free to transact profitable business, instead of being forced to devote a very considerable proportion of their time to merely clerical work.

In conclusion, it is proposed to take one transaction right through the settlement. We have already considered how an order to purchase certain Stock is executed on Change. When the next settlement approaches, the Broker will ascertain from his client whether he intends to take that Stock up or to carry over. If he intends to take it up, the Broker will issue a memorandum, which is called a "ticket," to the Jobber, informing him of the name into which the Stock is to be placed. The Jobber hands his ticket to the Clearing House, and the Clearing House decides who has to hand to the Broker a transfer for the stated amount of Stock into the name of the Broker's client. That transfer, accompanied by

a certificate for the Stock, should reach the Broker on the pay-day, in exchange for which the Broker must pay the agreed purchase-price. He will, however, not hand over the transfer or the certificate to his client, until his client has paid him. On the other hand, if the Stock is to be carried forward, the Broker will notify the Jobber to that effect, and the purchasers who wish to carry forward will be paired off against sellers who wish to, or are willing to, carry forward as far as possible, with a view to saving quite unnecessary transfers.

Options.—Options are mostly dealt with by "outside" Brokers, but they can be entered into with certain members of the House who are willing to quote prices. The idea is that, in consideration for a cash payment, the Broker or the Jobber will quote a price at which the member of the public has the right to sell shares on a specified date, or the right to buy shares on a specified date, as the case may be—either or both. Either right may be secured, or both rights may be secured; but of course if both rights are secured, only one would be exercised. If the price has altered in the meantime, of course the option may be exercised with profit; but if the alterations in price have been unfavourable to the option holder, or if there have been no alterations, then the price paid for the Option is a dead loss to the option holder, and a clear profit to the member "on Change." The unsatisfactory feature of Option business, of course, is, that it is practically impossible for the man giving the Option, or selling an Option, to cover himself entirely as he goes along. The business of a Jobber, one may say, consists almost entirely in covering his business as he goes. Directly he has sold, say, 100 Shares of a particular

company, he is much more anxious to buy shares of that company than to sell them, and so on. He has no ambition to run up a big account one way or the other. He merely tries to cover his deals, so long as he can do it without actual loss. With Options, however, it is practically impossible to "undo" the business thoroughly; and in the meantime, as cash is received in advance, the business seems to be very much more profitable than it really is. It is practically, of course, a form of insurance business, and no insurance business is on a safe basis unless a very large volume of business can be undertaken —so large as to give the person conducting the business a reasonable prospect of getting a fair average experience, and not finding that he has lost because of an exceptional run of bad luck. A run of bad luck may easily affect the course of a limited number of transactions very seriously. With a very large number of transactions there is no such thing as luck, and therefore legitimate insurance business may be made safe; but probably no member of the Stock Exchange undertakes a sufficient quantity of Option business to get up to that standard, and therefore the prices charged for Options are either unreasonable, or there is not the absolute certainty that there ought to be that the person giving the Option will be able to carry out his undertaking when the time comes.

CHAPTER X

THE ORGANISATION OF CREDIT—INSTRUMENTS OF CREDIT

Credit and Barter.—Credit, as the name implies, is really a belief that business men will carry out their obligations; and where that belief does not exist, or where it is uncertain, there can be no credit in the proper sense of the term. Thus, Credit is necessarily almost entirely a result of the growth of civilisation, and must be much more recent than business transactions themselves. In early times, apparently, all business was a matter of barter, and those who wished to secure certain commodities had to offer in exchange such commodities as they had a superabundance of; if they were very anxious to secure what they were endeavouring to obtain, they had to make correspondingly large sacrifices of what they were able to give, which, perhaps, the person with whom they were negotiating was not himself particularly anxious to secure. Where one could find willing exchangers on both sides, doubtless there would be a better and more equitable bargain than if only one of the two parties was anxious to effect a deal; but until some form of Credit was brought into existence there was really no other method of acquiring property—except,

of course, force of arms, which, no doubt, entered fairly generally into the distribution of wealth in early days.

Money.—The first step, no doubt, in the direction of Credit was the somewhat limited one of recognising something as representing an effective currency in money. Some particular form of commodity came to be regarded as of use in these exchanges, not merely for its own sake, but also on account of its potential possibilities of being afterwards exchanged for any commodity that might be desired. That, of course, is really where the value of money comes in. In itself, although it may have an intrinsic value, in that it is capable of being turned to uses by way of jewellery and so on, the real value of money lies in the belief that it can always be exchanged for commodities, and in that way various commodities have from time to time served the purpose of money. In certain parts of Central Africa at the present time cloth for all practical purposes takes the place of money as a medium for the exchange of commodities; and in times when the weather is bad, and the roads—such roads as there are—are impassable, and when the periodical consignments are in consequence delayed, the purchasing power of cloth increases considerably with the scarcity of the available supply; and, of course, the purchasing power falls again when the periodical consignments come to hand, and the quantity available for this purpose is thus less limited. But whatever precise form the money may take—whatever commodity may be doing duty for money—while it is being so used it is, of course, useless for any other purpose. It is practically locked up in this form, and non-productive.

Difficulties of Transport.—With a very primitive civilisation, and a consequent absence of Credit, property will only change hands at the same time as a corresponding amount of money passes from the purchaser to the vendor, and it will readily be understood that this must materially interfere with commerce between distant parts. It would interfere even with commerce between adjacent villages, on account of the loss of time occupied in the journeys to and fro. Really, the pure and simple barter would be a more convenient arrangement, as far as it would be practicable, for commerce between two villages. Goods would go from one village to the other, there be exchanged for commodities desired in exchange, and taken back in the one double journey; whereas, if the two transactions had to be dealt with separately as actual purchases for which payment was made in money, there would have to be the two journeys. There would be all the waste that still occurs when it becomes necessary to send bullion from one part to another; and, in precisely the same way, any transit of money from one place to another is a transaction producing no wealth in itself, and therefore one as far as possible to be avoided.

Credit facilitates Exchanges.—It is in so far as one is able, by means of Credit operations, to avoid the necessity of transferring money from place to place in this wasteful, and really unnecessary and purposeless, way that one gets the full benefit of a sound state of Credit; but, of course, Credit operations can only be expected to be carried out while the belief remains firm that the reason why they are not accompanied by an exchange of money at the same time is solely on account

of this very natural desire to save waste. Directly there is any serious doubt as to the ability to supply the money in exchange, the Credit basis begins to crumble; because men then have of necessity to consider the possibility that they may not get anything in exchange when they want it.

And tends to Increase their Volume.—Another point to be borne in mind is, that, by substituting Credit for cash transactions, one is at once able enormously to increase the number of those transactions. If no transaction could take place—no matter how far apart might be the two places affected by that transaction—without the money passing in exchange for the goods, it would be necessary not merely at every hour of the day and night to have large quantities of goods in process of transit, but equal quantities of money would have to be continually in transit. One would therefore soon reach the limit, that one's purchasing power would be stopped because all one's available money was on the road, and it was impossible to engage in further transactions until some of these journeys had been brought to an end. If the money is not obliged to go upon the road separately in respect of each individual transaction, but is only sent periodically to adjust balances between different towns or countries, the quantity necessarily upon the road (or upon the seas) at any one time is enormously reduced, and therefore the same quantity of money may be made to do duty for all practical purposes in connection with an infinitely larger number of transactions.

Risks of Transmitting Money.—Again, obviously, at whatever stage of civilisation a community may be, there is every argument in favour of handling money as rarely

as possible, and of sending it upon journeys as rarely as possible. It is not only that the time and trouble and expense of the journey represent for all practical purposes a pure waste economically; there are the risks of loss involved. There is, first of all, the inevitable risk of loss of weight arising from the handling of any commodity. The loss of weight may not be serious in connection with any one journey, but in the course of time it must represent an appreciable amount; and therefore the less money is handled, the less will be the loss arising from this cause. Secondly, there are the risks of loss because the money is no longer in safe keeping. While in transit it is open to the perils of the road and of the sea; and although so far as the perils of the road are concerned they may have been enormously reduced by civilisation and good government, they cannot even now be said to be altogether extinguished. Like perils by sea, they may be insured against—but insurance against a loss does not, of course, prevent the loss from happening. It merely arranges for the transfer of the loss from one pair of shoulders to another; or, to put it more accurately, for the spreading of the loss over a very large number of shoulders, so that the burden is practically imperceptible. The loss will remain the same, as a loss to the community as a whole, and is therefore one which it is desirable as far as possible to avoid.

A Clearing House for Exchanges.—The whole of the tendency of the organisation of Credit seems to be really as far as possible to retain the system of barter, and to use money as little as possible upon the sale and purchase of goods—particularly, of course, where those

goods are sent a considerable distance to effect a sale, and where, therefore, the question of the transport of money would be the most serious item. But the barter, instead of being upon the elementary basis that it was in earlier times, is now rather upon the basis of a general Clearing House. In the preceding chapter it was explained that at a Stock Exchange settlement transfers are not actually executed and registered in respect of each bargain undertaken during the fortnightly account; as far as possible these bargains were set off against each other, completed bargains eliminated, and transfers only executed in respect of outstanding bargains which involve that certain individuals should receive certain parcels of shares against payment, and certain other individuals receive payment against corresponding parcels of shares. Except in so far as these outstanding transactions were concerned, the operation of the Clearing House is practically to cancel out all the intermediate transactions and to bring the original seller and the ultimate buyer face to face, thus, of course, enormously reducing the amount of work involved. The same kind of principle governs the commerce, say, between two countries. In each country there are certain persons buying goods from the other: in each country there are certain persons selling goods to the other. If the purchasers were invariably to remit money to the vendors in the foreign country, there would have to cross the frontier—or the sea, as the case may be—an amount of money equal to the total sales and purchases of one country; but if in any way some sort of Clearing House could be arranged, by which those entitled to receive money in (say) this country may receive that money not

from their foreign debtors, but from some other persons resident in this country who are liable to remit money abroad, in so far as these transactions can thus be set off against each other, the necessity of remitting money in either direction is entirely avoided. The necessity of remitting money is thus reduced to the necessity of remitting a sum of money equal to the difference between the totals owing respectively by the two countries; and that in its turn may be reduced to a minimum by making this Clearing House system general, instead of confining it merely to two countries. If it be extended to all countries having mutual transactions, the amount of money that would actually have to pass from one country to another will be reduced to a minimum, and over a long period of time the tendency will be for it to be reduced as nearly as possible to zero. Of course, it does not really come down to anything like zero in practice, but it will always be quite small as compared with the aggregate value of the transactions.

Its Effect on Prices.—This Clearing House arrangement has also a reflex action upon prices. There will be a tendency for the country that is primarily liable to remit money to try and avoid doing so by forwarding goods instead; and, in proportion as it is anxious to avoid remitting money, will it increase the quantity of the goods that it would be willing to export instead of exporting money. This, of course, tends to a very large extent to keep fairly steady the balance as between one country and another.

Bills of Exchange.—Now, clearly men of business all over the world are not known to each other in the way that members of the London Stock Exchange are;

consequently, anything approaching a Clearing House system upon Stock Exchange lines would be impracticable. It proceeds upon lines which may be said to have their original basis in the business relations between a merchant and his agent in some foreign country. Suppose that A is an English merchant, having an agent, B, say, in South America. A exports goods to B for B there to sell to the best advantage. If A has occasion to buy goods in South America, instead of remitting payment for those goods from England, it will clearly be more convenient if A can so arrange matters as to instruct his creditor to collect the money from B, who, having goods of A's in hand—and perhaps money owing to A in hand—will be willing, upon receiving instructions to that effect, to pay any debts that A may owe locally, and then, of course, to remit to A only the balance due after making those deductions. To enable such arrangements to be carried out systematically, and more or less with certainty, they must clearly be carried out in writing, and the Bill of Exchange—the Acceptance—is really based upon these lines, as being an order drawn by some one (A) upon another (B), who is accountable to him (A) for certain monies or certain goods, directing him (B) to make payment to a third party (C). This order is sent to the third party (C), who accordingly presents it for payment to the person upon whom it is drawn (B). If he (C) is able to collect the amount of his debt there, he may be regarded as being finished with; the indebtedness of the drawee (B) to the person who drew upon him (A) has been reduced accordingly, and thus there is a smaller balance remaining to be remitted between those two parties (A and B), and all

need for a remittance between the drawer of the bill (A) and the person to whom it is payable (C) has been avoided.

Foreign and Inland Bills.—Bills sent abroad are commonly framed upon these lines, drawn upon agents, and made payable to third parties to whom the drawer is desirous of making some remittance; but for some purposes the convenience of the Bill is such that it is commonly used as a medium of settling accounts where there are only two parties concerned, and not three. That is to say, a man often draws upon another inviting him to make payment to the drawer. That would appear to be a quite unnecessary proceeding, if the payment were to be immediate; but very commonly—and, indeed, most usually—Bills are not payable on demand, but are expressed to be payable at some definite or ascertainable future date. Whether they be payable to the original drawer or to a third party, if they have been accepted by the person on whom they are drawn, a position of affairs is established which is very convenient for the interchange of Credits as an alternative to the transfer of actual monies.

Practical Utility of Bills.—The law relating to Bills of course varies slightly in different parts of the world, but for present purposes there will always be this effect—that the existence of a debt legally due has been established beyond possibility of dispute. If a man is merely accountable to another for goods, or for money lent, there may be a dozen arguments as to whether he owes anything, and if so, how much. There can be no real discussion as to what is due upon a Bill of Exchange. Secondly, a Bill is payable on a

definite date, instead of upon a more or less indefinite one. Thirdly, in practically every country, in default of payment the legal proceedings necessary to enforce payment are far simpler when one is claiming as the holder of a Bill of Exchange than if one is merely claiming payment in respect of any unsettled transaction, or series of transactions. And, as a result of all these advantages, Bills are readily transferable. If a responsible man has been tied down so far as to give a Bill of Exchange, one knows that, unless he should fail in the meantime, it is practically certain that he will meet that Bill when it becomes due. The result is that if the person liable to meet the Bill is a person of good repute, there is little difficulty in selling, or transferring, one's rights under that Bill, and the ease with which a Bill may be transferred is greatly increased by the fact that it is legally what is called "negotiable"—that is to say, the holder can readily establish a right to be paid the amount due under the Bill without being called upon to prove how he came to be in possession of the Bill. There can be no sort of counter-claim raised, that since the Bill was given the person to whom it was originally given has become indebted to the person liable under the Bill. A good title to payment may readily be established by any stranger presenting the Bill for payment; with the result that such Bills, like everything else of value, may be readily bought and sold among persons to whom such transactions appear profitable or convenient.

Buying Bills.—As a result, if a man finds it necessary to make payment of a certain sum of money (say) in New York on a certain date, instead of remitting the money it may suit his purpose to collect Bills payable

on that date by persons residing in New York and send them to his creditor instead. That process of collection would, of course, be impracticable on the part of ordinary business houses; but it is quite practicable in connection with Banks, because Banks are known to each other, and have agents practically all over the world. Very commonly, therefore, a business man desirous of making remittances abroad will do so through his Bankers; but for all essential purposes what really occurs is that there is a sort of universal Clearing House in respect of Bills of Exchange, designed to avoid the necessity of remitting monies from one town to another, or from one country to another, more than is really necessary.

Trade and "Fine" Bills.—Commercial Bills, or "trade bills" as they are called, are of course subject to a certain amount of risk—the risk of bad debts. Bills given by Bankers, technically known as "fine bills," are only subject to a very remote risk of loss by way of bad debts, because it is, of course, relatively speaking, much rarer for Banks or financial houses to fail to meet their engagements than it is for commercial houses so to do. That is why the charge made for discounting trade bills, that is to say for turning them into money, is heavier than the charge in respect of fine bills. The risk of bad debts is taken into account. But the risk of bad debts to a person accepting a Bill of Exchange in payment of a debt is not as a rule very serious, because every person whose signature appears upon that Bill is jointly and severally liable to pay the amount. The person primarily liable is, of course, the acceptor; but, failing him, the person drawing the Bill is liable to any other party in whose hands the Bill may be; and if the Bill passes

through several hands before being ultimately presented for payment, it will have been endorsed by each of these successive parties, and each of those endorsers becomes liable to the ultimate holder. So that, where there are several signatures on a Trade Bill, the risk of ultimate loss is really very trifling ; but there is in the meantime, of course, the risk of what may be a very serious inconvenience—delay in payment.

Cheques.—Cheques only differ from Bills of Exchange in that they are invariably payable on demand, and that they are drawn upon Bankers, instead of being drawn (as Bills frequently are) upon ordinary business houses. Because they are payable on demand, no necessity arises to present them for acceptance. When they are presented payment is demanded, and therefore the need for acceptance does not arise. But for all other purposes a Cheque may be regarded as being identical with a Bill of Exchange, and it possesses the same advantages of representing an admitted debt, of being payable on a definite date, and of being negotiable.

"Not Negotiable" Cheques.—The advantage of being negotiable may, however, be withdrawn (so far as this country is concerned) by the process of "crossing" and adding the words "not negotiable." The effect of those words is not to make it illegal, or impossible, for the Cheque to change hands, but merely to throw upon the party presenting the Cheque for payment the onus of proving that he is entitled to payment as against the drawer. If a "not negotiable" Cheque has been stolen by some intermediate party, the ultimate holder cannot give a better title than any one of the previous holders, and therefore can give no better title than the thief, who

had no title at all. The practice of crossing a cheque "not negotiable" is therefore some protection to the drawer against loss, should the Cheque be stolen, and it does not seriously interfere with its negotiability for ordinary practical purposes.

The process of crossing a cheque at all has the effect that the holder cannot present it for payment in person, but must present it through a Banker. The only practical advantages of crossing cheques are that they cannot be marked "not negotiable" without being crossed, and that the process of crossing, whether they be marked "not negotiable" or not—requiring, as it does, that they shall be presented for payment through a Banker—enables them to be traced, and the person actually receiving the proceeds eventually to be discovered.

Cheques as Money.—Cheques, being payable on demand, may be used for many purposes for which Bills of Exchange would not be very suitable; as, for instance, when it is desired to make prompt payment, instead of to arrange for payment on some definite future date. Where Credit exists—that is to say, where there is confidence between the parties—cheques, for the great majority of purposes, are accepted as readily as actual cash, and thus here again they serve the purpose of avoiding the necessity of carrying large sums of money from one place to another. What is perhaps more important still, they enable business transactions to be settled as between one party and another with the use of a minimum quantity of actual coin in circulation.

Certified Cheques.—But sometimes a cheque will not be regarded as being equal to actual money; as, for instance, when property of actual and considerable value

is delivered over in exchange for it. It is customary, for instance, when sales of land take place, to require payment in actual money, that is to say either in coin or in bank notes; but, to avoid inconvenience, the risk of loss, and the possibility of having to carry large sums through the streets, and for other reasons, what is called a Certified Cheque is commonly accepted as being equal for all purposes to actual money. A certified cheque is one drawn upon a Banker, which has been presented to that Bank and marked by it, a practice which for all ordinary purposes is equivalent to the cheque being "accepted" by the Bank, as a Bill of Exchange is accepted by the drawee. The Bank thus becomes unconditionally liable to pay a certified cheque, when presented, to the person in whose favour it is drawn, or to his order; or, of course, if the cheque is payable to bearer, then the Bank becomes unconditionally liable to pay to the bearer. In this way it is possible to get the practical advantages of the cheque, and yet to avoid the possible risk on the part of the recipients that they may be parting with something valuable in exchange for a worthless piece of paper.

Lost Certified Cheques.—The only drawback of a certified cheque is, perhaps, if it should happen to be lost. If an ordinary cheque is lost, payment can be stopped, and if that cheque is afterwards presented for payment, the Bank will refuse payment, leaving the holder to take what remedy he likes against the drawer of the cheque; and, of course, if the holder has no title to the cheque he would have no remedy whatever. But with a certified cheque, the Bank, having once accepted responsibility for it, will not accept instructions stopping

payment; accordingly it will retain in hand sufficient monies on the account of the drawer to meet that cheque. The result is that, if a man once presents a cheque to a bank to be certified, from that moment he has, for all practical purposes, parted with a corresponding amount of money; and if the cheque should be accidentally destroyed, that is his loss. A Bank will commonly consent to stop payment of a certified cheque —that is to say, to allow the drawer to draw against the monies a second time—upon receiving a Banker's guarantee against loss, or the guarantee of some responsible insurance office, but it holds itself liable to pay the original certified cheque should it be presented. For that reason certified cheques are not much used; but within limits they have their scope, and they certainly have several advantages, as compared with the necessity of making payments of large sums by way of bank notes or gold.

The Collection of Payments by Bill.—So far as business houses are concerned, it is usual for the acceptor of a Bill to limit the acceptance by making the Bill payable at a specified bank where he has an account, and the Bill must then be presented for payment at that Bank. That is, of course, for the convenience of all parties. It is a convenience to the acceptor, because it makes it unnecessary for him to keep considerable funds in hand to meet Bills as they are presented for payment. It is an even greater convenience to collecting Banks, because all they have to do is to sort out their Bills and present them for payment (more or less in bulk) through the Clearing House to the Banks at which those Bills are respectively payable, instead of being obliged to send each

Bill by hand and to collect the proceeds at the acceptor's place of business. But Bills are occasionally given by what may be called non-commercial parties, and, as a rule—at all events in the absence of express instructions—banks will not pay Bills for non-traders without having been specially advised. It is usual, therefore, for non-traders either to advise their Banker specially in respect of each Bill accepted, or in some cases they may find it more convenient not to limit the acceptance by making the Bill payable at their Bankers, but merely accept it generally. When so accepted the Bill must be presented for payment at the business address of the acceptor, and to avoid the inconvenience that he would otherwise incur of having to keep the money in hand all day, and having to wait in all day until the Bill is presented, it is not at all uncommon for the acceptor to draw a cheque in favour of his own bankers (if he does not know the holder of the bill) or a cheque payable to bearer: in the top left-hand corner he marks the cheque, "pay against Bill due this date." Then, when the holder calls with the Bill for payment, he is handed the cheque, and he presents the cheque and the Bill together at the acceptor's Bank, and the Bank then cashes the cheque and hands the proceeds of the cheque over to the party producing the Bill, receiving the cheque and the Bill in exchange. That is one way of getting over the inconvenience of large sums of money having to be handled, which would otherwise be necessary unless Bills were invariably paid at Bankers. It is, of course, not an ideal method from the holder's point of view, because it is much more difficult to collect a Bill when one has to make two calls, instead of merely paying the Bill into one's Bank for collection;

but it is a practice which, although not very general, is certainly not altogether unknown, and it is one therefore that it is just as well should be mentioned. If one were not acquainted with it, one might be disposed to regard the rendering of such a cheque in exchange for a Bill as being a very inadequate way of meeting that Bill. It would doubtless be inadequate, if the holder of the Bill were expected to give it up against the cheque, for if he gave up the Bill before he actually received payment he would lose his right of action against any third party liable under the Bill; but it is a way of instructing Bankers to pay a Bill which may be adopted at the eleventh hour where the Bill has not been originally accepted as being payable at a particular Bank. In cases, for instance, where a man has changed his Bankers —or expects to change his Bankers—during the currency of a Bill, it may be perhaps the most convenient arrangement; but it is obviously too cumbersome to be generally employed, and is nothing like so convenient as the more usual practice of making Bills payable at Banks, which entirely obviates the necessity of handling money at all in connection with them, save in those exceptional cases when they are presented for payment across the counter instead of through the holder's bankers.

Bank Notes.—Before concluding this chapter it is desirable to consider two other instruments of credit in common use, viz. Bank Notes and Warrants. A Bank Note, as is clear upon the face of it, is a Promissory Note, and a Promissory Note is merely another form of Bill of Exchange. The form more ordinarily used for commercial purposes is the Acceptance; that is to say, the Bill drawn by the creditor and subsequently

accepted by the debtor; but a Promissory Note drawn by the debtor himself is a Bill of Exchange, and follows the same general rules as acceptances. In the case of a Bank Note, however, the promise to pay is invariably a promise to pay on demand, and a promise to pay to the bearer; whereas other bills of exchange are commonly payable at some future date, and to the order of some person therein expressed as being the payee. So far as this country is concerned, the issue of Bank Notes is practically almost confined to the Bank of England; but the right of issuing Notes is still preserved by a few Banks, and it is as well, therefore, to mention how that right has survived. In the early days of banking there were no regulations with regard to the issue of Bank Notes, and therefore any Bank that thought fit was free to issue them in exactly the same way that commercial men are to this day free to issue promissory notes in discharge of indebtedness; but when the Bank Charter Act of 1844 was passed, the Bank of England was given a monopoly to issue Bank Notes in the metropolitan district, and consequently the right (general) to issue Bank Notes, as from that time onwards, was limited to provincial Banks. As time went on, the tendency has been for these provincial Banks gradually to be absorbed by joint-stock Banks, which carry on business in London, even if their headquarters be not in London; and as each of these old private Banks becomes amalgamated with a concern having headquarters or branches in London, the right to issue notes lapses, so that it is now limited to a very small number of old-established provincial Banks having no branches in London. Bank of England Notes are legal tender, and therefore for

commercial purposes may be regarded as practically the same thing as coin, and they, of course, possess the advantage of being very much more portable. Country Bank Notes are not legal tender, and, as a rule, do not circulate freely at any great distance from the head-quarters of the Bank issuing them, partly because the status of these provincial Banks is not generally very well known—partly because of the difficulty of cashing the Notes if one is not conveniently near to the Bank's place of business, where payment may be demanded in cash.

But although, of course, Bank of England Notes possess advantages, as being legal tender and as being extremely portable, they have the inconvenience (for some purposes it is an inconvenience) of being negotiable, and therefore payable to whomever may present them for payment. The consequences of a lost Bank Note are therefore more serious than the consequences of a mislaid Bill of Exchange or Cheque, the payment of which may more readily be stopped as a rule.

Warrants.—A warrant is for all practical purposes a Cheque with certain variations. It is not invariably an order upon a Banker to pay ; sometimes it is an order upon a Paymaster or Treasurer, who, for that limited purpose, may be regarded as undertaking a banking business on behalf of the parties issuing the Warrant. Almost invariably the Warrant expresses upon the face of it the consideration out of which the debt arises, and the signature of the payee therefore for all practical purposes serves as a receipt for payment of the debt; whereas, when remittances are made by Cheque, it is usual to regard it as being unsatisfactory if a separate

and formal receipt cannot be obtained in addition to the endorsement of the cheque. At the same time a modified form of Cheque seems to be coming into fairly general use, which provides a formal receipt upon the back or at the foot thereof, so that the endorsement of the cheque over a penny stamp constitutes all the receipt that is required. Clearly, however, it is a more satisfactory form of receipt if the document states upon the face of it what the payment is for. Another point about Warrants is, that in some cases they are only conditional orders to pay, instead of being absolute or unconditional orders. For instance, a Pay Warrant in the Army or Navy requires to be supported by a declaration made before such persons as may be prescribed—usually a Justice of the Peace, or a Banker, or a Minister of Religion—that the payee is actually alive at the time and therefore entitled to draw his pay. Warrants of various kinds are used, not merely in connection with Government pay, but also for the payment of other accounts due by Government Departments; and many Local Authorities also employ somewhat similar Warrants, addressed to their respective Treasurers, in place of cheques. Another—and perhaps better known—form of Warrant is the Dividend Warrant, issued for the payment of interest due on Public Funds, or of interest or dividends payable by public companies. These Dividend Warrants are only distinguishable from Cheques in that they state upon the face of them what the payment is for.

The Stock Exchange and Cheques.—As illustrating the extent to which Credit operations are carried under suitable conditions, the enormous sums that change

hands on Stock Exchange settling days may be instanced. These are entirely paid by crossed cheques payable to bearer; and against cheques not only registered stocks and inscribed stocks change hands, but also bearer securities—negotiable securities to which the holder has a title against all comers—are quite cheerfully parted with between one member of the Stock Exchange and another. This is done chiefly in order to save time; and because, of course, the transactions are very heavy on a settling day, these cheques are invariably payable to bearer, so that they may not require to be endorsed by the payee. The only evidence, therefore, that the cheque actually was received by, or used for, the benefit of the payee, is the record kept by the Bankers—as the cheques are invariably crossed; but they are never marked "not negotiable," and they are never payable to order, yet the number of cases in which disputes or losses arise in connection with them are infinitesimal. At the same time, there is, of course, a vast difference between what is practicable in the way of credit operations between the members of one society, who are all mutually known to each other, and have all had to give considerable hostages to fortune in the way of entrance fees, and as between business houses which may occasionally find it convenient to have mutual transactions, but in the majority of cases really know surprisingly little about each other's character or financial position.

CHAPTER XI

THE ORGANISATION OF CREDIT (continued) *FOREIGN EXCHANGES*

Bills "against Documents."—The preceding chapter was devoted to a consideration of the various methods of discharging indebtedness without remitting actual coin in payment, by the operation of Bills of Exchange and for similar Credit transactions, and it was pointed out that although commercial bills, or "trade bills" as they are called, are very freely utilised for this purpose, yet they are not quite so readily accepted as Bills issued by Bankers and financial houses, which are technically known as "fine bills." That being so, the reader may be inclined to wonder why remittances are not invariably made by fine bills. There are two fairly good reasons for the more general use of trade bills. The first is that, unless they were to be utilised in this way, upon a Clearing House system, so that only the balance had to be remitted in one direction instead of the gross amounts in both directions, the cost of remittance would be very considerably increased, and that would naturally mean that in the long run business men got less value for their money. In the second place, trade bills in a sense provide greater security under some circumstances,

which is perhaps more important than the possible risk of bad debts. Supposing one is forwarding goods, say, in execution of an order received from a comparative stranger abroad. One may make what inquiries are possible, but extensive inquiries are not very practicable without unduly delaying the execution of the order: in any event one would be somewhat at a disadvantage, if one had to sue a debtor resident in a foreign country, partly because the laws of that country would quite possibly favour the native trader, partly on account of the difficulty of successfully conducting litigation at a distance with the aid of foreign lawyers whom one cannot instruct verbally. It is quite practicable, however, instead of forwarding the goods to the foreign trader, and requesting him to forward in exchange a Bank Draft, to ship the goods in accordance with instructions received from the customer, and to forward the shipping documents to a Bank in the foreign country having a branch (or headquarters) in this country, with instructions only to part with those documents provided that the Bill that the manufacturer sends with them is duly accepted by the foreign trader in exchange. If those instructions are issued to a Bank having a branch in the foreign country, it is impossible for the foreign customer to obtain possession of the goods without first of all accepting the Bill for the value thereof, and the trader at home is thus in a very much stronger position than he would have been, had he parted with possession of the goods without receiving in exchange a formal acknowledgment of indebtedness of any kind. If he receives in exchange an Acceptance, he is in a position to discount that Acceptance, and the then holder for

value may demand payment without any risk of a defence being made that the goods are in some way defective, or not up to sample. The whole of the risk (from a business point of view) is thus really transferred to the purchaser, who may find out, after he has accepted the Bill, that the goods are not what they ought to be.

Advantages of Deferred Payment.—There is yet another practical advantage of Trade Bills over Fine Bills, or Bank Drafts, that it is practicable to make them payable at a future date. It would, of course, be equally practicable to make a Fine Bill payable at a future date, but very little discount would be obtained for that as compared with a Trade Bill. The employment of the Trade Bill, payable at a future date, gives a purchaser the opportunity of disposing of the goods, and himself collecting payment in time to pay for those goods with their actual proceeds; and consequently he only requires a capital of his own to cover contingencies, instead of the very much larger capital that he would require, if he had to pay cash in respect of every purchase. The vendor, on the other hand, may please himself as to whether he retains the Bills until maturity, or as to whether he discounts them during the term of their currency and thus obtains payment practically on the date of delivery (or very shortly afterwards), subject, of course, to having to pay a charge by way of discount to the Bankers, or other parties, who may lend him money on the Bill in the meantime.

Foreign Exchanges.—But no consideration of this question of foreign Bills of Exchange would be adequate, were we altogether to leave out of account the question of foreign currencies. If trading operations take place

between the inhabitants of different countries employing different currencies, it is clear that those transactions must take place in a currency which, from the point of view of one party or the other, is a foreign currency. It is, of course, entirely a matter of arrangement as to which currency shall be employed, but usually the importer has to buy and to pay in a currency which to him is a foreign currency; and usually the exporter receives payment in his own currency. Now, to whichever of these two parties the transaction is expressed in a foreign currency, there arise various questions which have to be carefully taken into account in connection with the fluctuations in the relative values of the two currencies. This relative value is commonly spoken of as being the "exchange value," and the fluctuation therein as "differences in exchange."

Fluctuations in Exchange.—Theoretically there is a definite ratio between any two currencies. If both currencies are based upon a gold standard, that ratio will depend upon the quanitity of fine gold in the standard coin which represents the unit of each currency, and fluctuations in exchange in that case will be caused solely by the question of supply and demand for remittances from and to abroad. At one time of the year the stream of remittances will probably be chiefly in one direction; if so, those who wish to remit in the same direction as the majority of their fellows will find that they have to pay a slightly higher price than if they wished to remit in the opposite direction, because, of course, if there is not an exact balance of remittances somebody has to be left out, and those who are desirous of remitting bid against each other in a way that forces

up the price; but, save in very exceptional circumstances indeed, the difference in exchange can only equal a sum equal to the cost of shipping gold, plus insurance and loss of interest during the voyage. In times of panic, however, the demand for gold might be so great that the difference in exchange would be even more than these items of the cost of shipment; but of course never for long—never for longer than the actual voyage would involve, and very rarely for so long as that, for of course there would be other (intermediate) countries that could be drawn upon.

Silver Money.—When the standard of both countries is a silver standard the position will be exactly the same as though it were a gold standard for both; but if one country has a gold standard and the other a silver standard, inasmuch as prices will be further disturbed by fluctuations in the relative value of gold and silver from time to time, exchange values will be determined, very largely, by the demand for these metals, and not merely by the demand for a particular currency.

Paper Money.—If one (or both) countries have an inconvertible paper currency, fluctuations will be further encouraged by passing events—political and financial—which may tend to depreciate the credit of the country supposed to be responsible for the paper issue. In all cases, therefore, there will be a certain element of uncertainty, or speculation, in connection with these foreign currencies—particularly so where one is comparing a silver and a gold currency, and silver happens to be fluctuating considerably; and especially so if one is comparing a gold currency and a paper currency, and there is anything approaching trouble in the "paper" country.

Dealing in Exchanges.—If, therefore, a merchant residing, say, somewhere in South America buys goods in England for sterling, he knows, of course, at the time he receives those goods what he will have to pay for them in sterling; but unless he is going to remit at once, he cannot say for certain how much it will cost him in the currency of his own country to pay for those goods in sterling at some future date. That will depend entirely upon the rate of exchange when he actually makes the remittance. There is, therefore, a considerable element of speculation as to what is a remunerative selling price to place upon those goods, and large profits might be made in times of considerable fluctuation out of favourable fluctuations, and *per contra* large losses might be made from unfavourable fluctuations. The probabilities in favour of losses being made are perhaps slightly higher than those in favour of profits being made, because to a large extent these fluctuations cannot be foreseen and are therefore purely questions of luck. Still, to a very limited extent they may perhaps be foreseen by the man possessed of the necessary knowledge; but foreign trading upon those lines would become a very speculative matter, if the purchaser were to "run" his bargains, so to speak, and to take his chance of the effect of exchange fluctuations. The result is that, as a rule, he covers himself by what is called dealing "in exchange." Thus supposing he only has to remit, say, in three months' time: he has purchased these goods, or perhaps he has them on consignment with an option to deal with them—he knows exactly what he can get for them in currency to-day—he knows that in three months' time he will have to

remit a Bill for a stated amount in sterling. If in three months' time the rate of exchange remains unaltered, it is a mere matter of arithmetic to decide how much he can make on those goods to-day: but the question is, how is he going to cover himself against a possible fluctuation in the meantime? He can do that by at once buying (and paying for in currency) sterling bills, that is to say bills made out in English currency. He thus avoids all possible risk, because, in exchange for the goods he has sold, he has secured the right to receive a stated amount in currency at some definite future date; in exchange for currency he has also acquired the right to receive sovereigns at some definite future date, and by that process he at once covers himself against any unfavourable fluctuation in exchange.

Speculation or Insurance?—Hence arises a rather paradoxical situation, that the real speculation in exchange —so far as foreign merchants are concerned—is where the merchant does not attempt to deal in "futures" in exchange. If he covers himself as he goes along by dealing in futures (*i.e.* the right to secure sterling at a definite future date), he has avoided the risk of unfavourable fluctuations; and what appears *primâ facie* to be a speculative, if not a gambling, transaction becomes a mere insurance against an otherwise unavoidable risk. As a matter of fact, this question of dealing in futures may be a perfectly legitimate business, and not mere speculation, in connection with many others besides Anglo-foreign traders; but for the moment it is unnecessary to go further than to point out how, in practice, it is possible for a foreign merchant to conduct a perfectly sound business without exposing himself to

the risk of loss in connection with unfavourable exchanges in currency. He has of course the risk, which is unavoidable in his case, of bad debts in connection with Bills. For purposes of remittance he buys the Bills of third parties, some of whom may be strangers to him; and if those Bills are not met, they will of course not be accepted in discharge of his liability. But that, after all, is a form of risk that every trader has to run every day in connection with his customers. It is merely extending the risk somewhat to run a similar risk in connection with purchased Bills.

"Good" Trade Bills.—With care such losses may be reduced to a minimum. Where they occur, it is usually because the merchant has been endeavouring to make an unreasonable profit on exchange. Although hitherto Bills of Exchange have only been divided into Trade Bills and Fine Bills, it will of course readily be understood that there must necessarily be very various grades of Trade Bills. There are some Trade Bills which for all practical purposes are as safe as any Fine Bill; there are some Trade Bills which, from the most optimistic point of view, cannot be regarded as anything approaching certainties. The quoted exchange rates represent the price charged for good Trade Bills, and in connection with these the risk of loss by way of bad debts is practically infinitesimal—partly by reason of the soundness of the financial position of the parties, partly by reason of their number (for there are, of course, at least two parties to each Bill purchased, if not more); but where exchange is unfavourable a man is sometimes tempted to avoid a loss, or to make a larger profit than usual, in purchasing Bills which do not command the

highest rate. He backs his opinion that those Bills will be met, and he comes to the conclusion that the risk of their not being met is not sufficiently serious to outweigh the obvious and immediate economy in price. If he is right, of course he makes the extra profit; if he is wrong, he makes a very serious loss as compared with the profit that he hoped to make. In normal circumstances prudent business houses would not be content to remit in anything but first-class Trade Bills, because the risk of loss on doubtful Bills is such that, in the long run, it is almost certain to eat up the temporary and immediate profit.

CHAPTER XII

THE ORGANISATION OF PAYMENTS

The Control of Expenditure.—It is, perhaps, hardly necessary to emphasise the importance of the best possible system in connection with the organisation of expenditure, both in the interests of economy and efficiency. In the absence of some suitable system, it is, of course, almost inevitable that leakage should occur —that the payments actually made should be in excess of the real requirements of the situation; further, they may fail to produce the intended result of providing the particular services, or particular form of equipment, best suited to the purpose in view. The best time to put forward the real strength of the organisation is to see that everything is in order before any payment is made; in point of fact, many systems of organisation seem almost to stop short at that point, but that is hardly carrying the matter far enough. When a legal liability has been incurred, that liability must be met; and if therefore the legal liability exists, no organisation of payments can help very much to control the actual expenditure. It is necessary to take the matter stage by stage: not merely to see that all money is paid away properly, economically, and efficiently; but also to see that no liability is incurred—credit not pledged

—without all proper safeguards in the direction of efficiency and economy. For the purposes of the present inquiry, however, we may conveniently work from the point of view of passing claims, or accounts, for payment; working back where necessary in order to see that everything is controlled at the proper time, and that the control is not exercised at too late a stage in the proceedings to be really efficient.

Methods of Control.—The work may be classified under four headings. They are not all by any means of equal importance, but they represent four different channels of inquiry. First of all, there is the verification of the claim itself, to see that the amount claimed is actually due; secondly, there is the classification of the claim, to see that it is charged up under the proper heading; thirdly, there is the identification of the claimant in order to make sure that the right party is paid; and, fourthly, to complete our organisation, we want to see that payment actually is made every time a payment is authorised.

Verification of Claims.—The verification of the claim is certainly that which calls for the most detailed inquiry. In the vast majority of cases we may take it that claims arise as a result of some voluntary act, and are claims for payment in respect of goods supplied or services rendered, or occasionally money lent; but there will also be claims arising involuntarily—claims for damages, either to person or to goods, which are beyond control in a sense, but which require to be very carefully considered in order to make sure that they are not allowed without due inquiry, and that the amount at which they are ultimately allowed is reasonable in itself.

The "Claims Department."—In many large concerns this inquiry into "involuntary" claims receives the attention of an independent department, involving considerable research in order to make sure that there is no leakage through extravagance or fraud. A department of that kind is almost certain not to be self-supporting—that is to say, it is hardly likely that the aggregate amount knocked off claims before they are finally adjusted will equal the cost of the Claims Department. But one has to remember that the proper point of view, when one is considering whether one will do something or leave it undone, is, what would probably be the real position of affairs if it were left undone? If one had no department for the verification of these claims, it is only reasonable to assume that they would be far more numerous, and far greater in amount, than if it be known—as it would naturally be known—that all claims are subjected to the closest scrutiny, and that therefore very little encouragement is given to the lodgment of bogus, or exaggerated, claims. Expenditure in a Claims Department, therefore, must be regarded as being preventive of possible leakage, rather than as being actively productive. It cannot be expected to show results which, upon the face of them, are self-supporting; but it may very reasonably be assumed that, if no such department existed, a sum considerably in excess of the net cost of that department would have had to be paid away for nothing.

Limitation of Authority.—With regard to claims arising out of voluntary acts, in requisitioning the goods or services of others, these naturally will arise as a result of definite orders issued or contracts entered into, either

directly or through agents. With a properly organised concern (and the larger and more important the concern, the more elaborate necessarily will be the organisation) the power of each individual must necessarily be subjected to definite limitations. In the case of a company, even the Board of Directors have limitations. There are points upon which they must seek the approval of the proprietors. Even the proprietors themselves, in general meeting assembled, will have limitations to their powers, and will be governed by the constitution of their particular Company, whatever it may be. With those in comparatively subordinate positions the limitations will naturally be far closer, and will be—or should be—very markedly defined. Those who are authorised to order goods, or to enter into contracts, should in all cases have limitations imposed upon them, as to what they are allowed to do without the express approval in each case of the Managing Director—or the Chairman, or the Board of Directors, as may be prescribed. For the daily conduct of the business it will no doubt be necessary to give limited authorities to pledge the credit of the undertaking to a number of persons occupying comparatively subordinate positions. They may, it is true, be departmental managers, or sub-managers; but, as compared with the Board of Directors, their position will be subordinate, and their limitations will be—or should be—very clearly defined. Commonly they will be limited to pledging the credit of the undertaking for some specific purpose connected with their own particular department. In a trading concern, for instance, departmental managers will probably be allowed to buy goods for sale in their respective departments, and will have no

other power of pledging the credit of the undertaking. In a manufacturing concern they might have a similar power with regard to the purchase of materials, or they might have the power of engaging "hands." The engaging of assistants in a trading concern would preferably not rest with the departmental managers, although most likely they would be consulted. Precisely where the line is drawn is, of course, a matter of policy, to be determined in each case by those who direct the policy of the undertaking. The point now insisted upon is the necessity of a clearly defined policy, and the necessity of continually seeing that it is carried out.

Branch Managers' Authority.—It is probably where an undertaking has numerous branches that the powers of departmental, or branch, managers will be most extensive, because what may be called the political control must in most cases be decentralised to some extent. Exceptionally, local Boards of Directors, or local committees of management, may locally assume the functions of the Board of Directors at home; but in the majority of cases that is hardly practicable, as being too expensive. Then the reins must be relaxed to a certain extent, and wider powers given to local managers. In many cases it has been found to work well in practice to give the local manager power to incur all expenditure that will be charged against Revenue. The local manager is then held accountable for—and his efficiency is judged by—financial results, by the profit shown from time to time by the Revenue Account; and that is found to be a sufficient safeguard against extravagance with regard to the expenditure chargeable against Revenue, assuming

of course that the right kind of man has been obtained for the post of branch manager.

Authority for Capital Expenditure.—But in such cases a good place to draw the line is undoubtedly with regard to Capital Expenditure. It would, in the great majority of instances, be a dangerous policy to authorise branch managers to incur Capital Expenditure without first obtaining sanction from headquarters in each specific case. In the majority of instances Capital Expenditure does not have to be incurred all in a hurry. If it is to be incurred prudently, and if one is going to make the money go as far as possible, one necessarily has to plan somewhat considerably in advance with regard to Capital Expenditure. Hence, as a rule, no practical difficulty will arise in the way of requiring the branch manager to send home recommendations and returns with regard to such expenditure, and in insisting that actual work must never be commenced until it has been sanctioned by the Board at home. Of course, in practical business there will probably be no rule without an exception. That is no reason for the abolition of all rules, but much unnecessary friction may be caused by too slavish an adherence to them. In quite exceptional cases a branch manager may be obliged to incur Capital Expenditure first, and apply for its authorisation afterwards; but it would have to be upon the express understanding that, if the authorisation is withheld, the expenditure will be charged against Revenue, and therefore will make the branch manager's accounts show unfavourably. If under these circumstances the branch manager likes to take the risk, on account of the urgency of the demand, there is probably no particular harm in

his so doing, provided the amount is one well within the limit of his authority for incurring Revenue Expenditure. The right type of manager is not likely to run such a risk lightly, and therefore, when he does, it will be in cases of real emergency. Of course, in any event, there would be a limit to the money value involved in a branch manager's transactions, so that the matter can never assume serious proportions unless the branch manager deliberately exceeds express instructions.

Large Orders.—Some business houses take the precaution of notifying all those with whom they think their managers are likely to do business, that all orders exceeding a stated limit must be countersigned by some stated person (*e.g.* as the secretary of the Company) before the Company will be bound by them. One may question the expediency of a general provision such as this. It seems to show a want of confidence in one's own managers, and can hardly make for the general reputation of the Company concerned; but, here again, each concern must be presumed to be able to judge its own particular circumstances best.

Method of Passing Claims for Payment.—To return to the question of the organisation of payments, the process of verification requires that the person responsible for the incurring of the liability should certify that the order has been duly executed, and that it was his order. It is, comparatively speaking, a matter of detail, so far as the present inquiry is concerned, who actually does the work of inquiry necessary before that certificate is issued. The probability is that the responsible departmental manager will be much too busy a man to make these verifications in detail himself; but he must accept responsibility for

them, and he may usually be left to select his own assistants in the work. Because he is to be held responsible he should sign the certificate ; but, as an additional precaution, the certification of the assistant (or assistants) who have actually done, or assisted in the performance of, the necessary work of verification should also be required.

Selection of Supply Houses.—Before leaving the question of authorisation it may be pointed out that the authority of employees to pledge our credit may be limited in another important way, and that is by limiting the business houses with whom they are authorised to have dealings. Here again occasional exceptions must be permitted in small matters. In such cases there would probably be little to be gained by limiting the discretion of the man primarily responsible for the expenditure ; but where large, or comparatively large, items are concerned, and where the items are frequent—and therefore bulk up into large figures—the whole thing becomes very largely a question of policy, and questions of policy are not for subordinates, even if they are relatively high up on the ladder.

Contracts.—A good plan in a large undertaking, where it is practicable, is to limit the expenditure in respect of which the man authorised is free to go where he likes to comparatively speaking quite small sums, and to require all expenditure exceeding a stated sum to be put out to contract. With regard to intermediate expenditure, he may be given a discretion as to whether it shall be put out to contract or executed by some one whom we will call a "permanent contractor"—that is to say, an outside business house who have contracted to

perform services of this description, or to supply goods of this description, during a stated period at scheduled prices. In many cases it is quite practicable to get annual, or other periodical, contracts for work at schedule prices, to be performed as and when required. Where practicable, it is usually well worth entering into such contracts, because of course one retains the option to place the order elsewhere if it can be placed more economically; and, of course, even if it serves no other purpose, it is a standby. It enables one to know who to go to to get work done at maximum rates, and provides a schedule of prices that will serve as a useful guide in order to see that no order is placed at excessive rates. Moreover, there would be not much risk of fraud, in the way of improper commissions being received by managers of departments. Doubtless in the majority of cases managers would be of a stamp to make that risk quite negligible; but, on the other hand, men will often do for the sake of friendship what they will not do for a bribe, and consequently where there is an unfettered discretion orders may be placed incautiously in all good faith, with the result that money is frittered away. If there is a standard schedule of prices with which to compare every order, it is at all events something of a safeguard, and (as already stated) it commits one to nothing in return.

Classification of Expenditure.—The next point is the classification of expenditure when authorised. This is really a much more important matter than it is sometimes recognised as being. There can be no effective control of expenditure, unless it is being continually watched and compared with expenditure in previous periods, having

due regard to varying needs. There can be no effective comparison, unless the same things are being compared with each other. Not merely must expenditure be arranged upon a classification which seems instructive from the general, and somewhat superficial, point of view of the periodical Revenue Account and Balance Sheet; one ought to have a much more minute classification of expenditure—one might almost call it a codification of expenditure—so that there may be absolutely no uncertainty as to the heading under which any possible item is chargeable. In the absence of such a guide, it is practically certain that similar items will sometimes be charged under one heading and sometimes under another, and then, of course, any comparison of one period's expenditure with another's becomes absolutely unreliable. In the interests of efficiency, therefore, a systematic codification of expenditure, under somewhat numerous headings, is of the very greatest importance; but, if it were to become general, it should serve the further useful purpose of often allowing comparison between the expenditure of one undertaking and another. Something of this kind is already in existence upon a limited scale. Municipal tramways, for instance, have practically agreed among themselves upon a uniform system of accounting which includes a codification of expenditure, so that there is no doubt as to precisely what items are included under each heading. Something of the same kind exists, it is believed, in connection with gas companies; but is less general, and much less perfect. As to how much further it extends the author is not in a position to say, beyond that one or two railway companies have, during recent years, given considerable

attention to the subject, and have produced very elaborate codes for the classification of expenditure; but whether they allow other companies the advantage of a perusal of their figures is doubtful. So long as business undertakings are run by private enterprise, it is of course necessary that each concern should consider its own interests first, and the possibilities of damage arising by giving too much information to possible competitors, or even to customers; and that no doubt will always stand in the way of any really reliable comparison between the accounts of one business undertaking and another of a similar description. But, where these conditions do not apply, there is everything to be said in favour of arranging accounts upon a common basis, rendering comparison possible, because the stimulus arising from the possible comparison of results on this basis really represents almost all that is left to take the place of the spur of trying to make a commercial profit that business undertakings possess.

Identification of Payees.—Passing on to the question of identification, although the inquiry here will probably be less elaborate, and occupy considerably less time, it is none the less important so far as it goes. There is very little use in arriving at the conclusion that certain expenditure has been properly incurred, and properly charged up under the correct headings, if payment be made to the wrong parties. One wants to satisfy one's self beyond all reasonable doubt that the payment is made to the party legally entitled to make the claim. For that reason it is usual, so far as possible, to defer payment until a claim has actually been lodged. Only in quite exceptional cases, and then only after exercising

all possible precautions, should payments be made prior to application therefor. The application in itself is to a certain extent a corroboration of one's own record that a debt is due, and at all events makes it possible to pursue inquiry into that claim in a slightly different direction. If the application be a personal application, as is normal in the case of applications for wages or salaries, no difficulty of identification will arise, so long as some responsible person can identify the applicant as being the person to whom payment is actually due. It should be part of the system of making all payments to insist upon identification in all practicable cases. There is no difficulty, of course, so far as the payment of wages is concerned; but formal identification is, of course, of little use if there is any risk of collusion. It is necessary therefore, as far as possible to ensure that the person identifying claimants can have no interest in—or is, at all events, very unlikely to have any interest in—payments being made to the wrong parties, or to persons not entitled to them. For that reason the foreman under whom men work directly is, as a rule, not a particularly reliable person for identification purposes. He rarely belongs to a class who are always sufficiently trustworthy; in the great majority of cases the work of identification would be honestly performed doubtless, but it is desirable to make matters more sure than that, and as a rule there will be no difficulty in the way, for the foreman immediately under whom men work would not usually be the man to engage them.

Evidence of Payment.—If payments are made in cash, it is clearly more important to be careful about the identification of the recipient than if payments are made

by cheque; and if payments are made by cheque and handed direct to the applicants, strict identification is more important than if they be remitted by post. But where cheques are crossed "not negotiable," and are only payable to the order of the claimant, the risk of their being misapplied is of course considerably reduced. From the point of view of the party making payment it is convenient that payment should, wherever possible, be transmitted by post, rather than that it should be handed over to some one who calls and asks for a cheque. This is, of course, the usual plan to adopt for all business payments. Exceptions are sometimes necessary; but in some cases exceptions are made where they are not really necessary, and then, of course, risks of loss arise that might have been avoided by the employment of a more efficient system of organisation.

CHAPTER XIII

THE "CREDIT DEPARTMENT"

Fluctuations of Credit.—The nature of credit transactions has already been considered in general terms, and their vast importance in connection with business organisation duly discussed. It is, of course, quite impossible to conduct business upon an extensive scale without the aid of credit; but it is—equally of course—quite possible, and indeed quite easy, to have too much of a good thing. Excessive credit is as much an evil, and as much an enemy of sound business, as is excessive distrust or the unreasonable restriction of credit transactions. Yet, as a matter of experience, one commonly finds these two following each other in fairly regular sequence, but in cycles of varying length. A period of general prosperity—partly by reason of the fact that everybody is making money, and therefore perhaps in a happier frame of mind, partly because everybody is busily engaged and preoccupied—tends as a rule to a slackening of reasonable precautions against the giving of excessive credit, with the result that losses arising from the indiscreet giving of credit are usually much larger after good times than after quiet times, and much larger in proportion. Then comes the inevitable reaction, and then as a rule

every one is over-cautious, and as a result their attitude retards the recovery of business generally. If such a frame of mind could be guarded against—if it were possible to ensure that these problems would always be looked at carefully, but never over-carefully—a good deal might be done towards levelling matters up, and avoiding on the one hand excessive booms, with their accompaniment of over-trading, and excessive depression on the other hand. Whether commerce generally is ever likely to become so organised, and so removed from the ordinary weaknesses of human nature, is perhaps a doubtful question; but anything that tends in that direction, in the way of a careful inquiry into what is to be avoided, and how best to set about it, is well worth attempting, as tending to avoid exaggeration.

Special Cases.—In a limited number of cases it is practically necessary to give credit to almost any one who may ask for it, and to rely perhaps upon some right that one may have to retain goods in hand pending payment as a means of avoiding loss, or a right (similar to that possessed, say, by water companies) of inflicting serious inconvenience by cutting off supplies in the event of non-payment as a means of bringing the necessary pressure to bear in securing payment eventually; but in the vast majority of cases, and in connection with all ordinary concerns, one is free to refuse to do business at all unless first satisfied that it is business of a character that it is desirable to undertake, in connection with which one is prepared to run the risk of eventually receiving payment of what is due.

The Giving of Credit.—Then comes the question, How is one to make the selection? So long as the amount

involved is comparatively small, the decision can probably readily be made by ascertaining the address of the would-be customer, and forming therefrom an estimate of his probable means. That is necessarily a very fallible test, for the most wealthy people do not always live in the largest houses, and *vice versâ;* but, in general, it is probably not far wrong, particularly when it is borne in mind that the class of person who has but small means and lives upon a lavish scale usually lives in particular districts, which get to be known as being occupied by that class of individual. Again (of course, with numerous exceptions, but so long as the amount involved is comparatively small) one may well consider—although, of course, one would not decide without due deliberation—that it is expedient not to hinder business by refusing to execute orders until after exhaustive inquiries have been made, but rather to run the risk up to a certain amount in all ordinary cases. In that event, however, one ought at least to determine what is the maximum sum for which credit is to be given without previous inquiry, and the amount, of course, will be very largely determined by the class of business. One would prefer always to make inquiries if it were practicable; but inquiries mean delay, and delay may mean the loss of the order.

Sources of Inquiry.—The next point is, supposing one is going to make inquiries, how should they be made? Now, there are only two broad sources of inquiry. One is to inquire of references given by the would-be customer; that is to say, inquiries from persons selected by him. The other is by independent inquiry through sources of one's own selection.

References.—With regard to references, roughly speaking there are three types of reference: (1) the bank reference; (2) the business reference; and (3) the personal reference.

Bank References.—The bank reference is a reference to the bankers of the would-be customer, which ordinarily is not given direct to members of the public, but only through the bankers of the inquirer. It is entirely limited to an opinion formed from an inspection of the Bank Account itself. It is therefore necessarily a very limited inquiry into means; but bankers have, of course, fair opportunities of forming an opinion with regard to their customers by seeing the movements that take place in their accounts, and they have, it is only reasonable to suppose, sufficient experience to interpret these indications upon broad lines. It does not at all necessarily follow that a man who invariably keeps a large balance is more wealthy than one who usually keeps his balance down to a very low figure; but bankers will be able to form at all events some judgment as to the financial standing of their various customers merely by perusing their own Ledger accounts with those customers. In particular they will be able to see whether they usually meet their engagements, by seeing whether any cheques or bills that they have issued have ever been returned dishonoured, or have to be referred back because there was not sufficient in hand to meet them, or because no arrangement had been made for an overdraft. A record of that kind against a customer is a point of information concerning which one would naturally be anxious to be informed, if one were considering the desirability of adding him to one's list of customers; but at best the banker's reference

is negative. It is not likely ever to show more than that, in the experience of that banker, there was nothing seriously wrong with the way in which his customer did his business.

Business References.—A business reference will presumably be a reference to a business house with whom the would-be customer has had transactions extending over a reasonable period of time. His point of view is perhaps slightly different from that of the banker. One may reasonably suppose that every one will make most serious efforts in order to keep his Bank Account in order, and to avoid having payment of his cheques or bills refused. An inquiry among all the trade creditors of such a man may bring to light cases in which he has been less precise in what he has done—cases in which he has asked to be allowed to renew a bill, hold over an account, or what not. But, on the other hand, one must remember that the business reference is to some one selected by the would-be customer, and that therefore it is only reasonable to suppose that he has made a selection that is not unfavourable to himself. The business reference has, however, this point in its favour, in the way of precise information, that it may serve as an indication of the amount of business transacted by our would-be customer, and thus it may suggest the desirability of limiting the amount of credit that one is prepared to give him accordingly. If other business houses in a similar position only do business with a man to the extent of £20 a week, one could hardly regard that as a satisfactory reference for a trade of, say, £100 a week.

Personal References.—The personal reference seems to be little used in practice for ordinary business purposes;

but to be reserved rather for positions of agent or employee, where one requires not merely evidence of ability and ordinary honesty, but also (as far as possible) evidence of a frame of mind, of a mould of character, suitable to one's purpose. Such references would no doubt be equally useful for all business purposes, if they were obtainable. If the amounts involved be small, it may well be thought not worth while to make so detailed an inquiry; but in cases of doubt, or if the amount involved is unusually large, personal references might well be asked for, as supplementary to bankers' references, particularly in the case of a business house anxious to open up new markets, and therefore willing to open accounts in neighbourhoods with which it is not familiar. After all, inquiry into the honesty and straightforwardness of a customer is at least as much to the point as an inquiry as to his means.

Inquiring Agencies.—With regard to independent inquiries, these are usually conducted through agencies that make it part of their regular business to give such information, and these agencies—in so far as they are genuine agencies (for there are many bogus inquiry agencies)—are usually run upon some sort of mutual, or co-operative, principle; that is to say, they are associations of manufacturers, or merchants, who are willing to exchange views with regard to customers—or would-be customers—the agency thus acting as a sort of "clearing house" for status information. Inquiries of that kind have at least the advantage that one stands a very good chance of getting an outside opinion upon the matter; but it must not be overlooked that, if a man is himself a large creditor of a business house, and he is nervous

as to whether he will get paid, it is asking, perhaps, a little too much to expect him to impart *all* his doubts to the first inquirer—with the result, perhaps, that, by so doing, he may be injuring his customer, and spoiling his own chances of eventual repayment. If a man only owes a large enough sum, it is practically in the interests of his creditors to keep him afloat.

Biassed References.—Of course all references ought to be *bonâ fide*, but quite a limited amount of experience will suffice to show that from time to time references are received which subsequent experience suggests could hardly have been *bonâ fide*. Probably as a rule this is not the result of anything approaching a deliberate conspiracy, but merely because, if an unscrupulous individual only owes enough money, he, to a large extent, has his creditors in his power. If the amount that he owed to each one was trifling—something which they could well afford to lose and forget all about—they would probably stop supplies, and have done with him. If the amount is too large for them to afford to lose, if they can help it, they have to "nurse" the account, and hope that something will turn up to help them gradually to withdraw. In such a case the advent of an inquiry, suggesting that there is some one else willing to supply this man with goods, perhaps of a similar description, is regarded not as an impertinence on the part of a pushing competitor, but rather in the light of an esteemed communication from some one to be welcomed as a saviour. There is a temptation—a very strong temptation in such a case—to forget the unpleasant things, and as far as possible to remember only the points that may be said in the customer's favour. To say the least of

it, unfavourable information is not likely to be volunteered under such conditions; the most that can be hoped for is a truthful reply to the precise queries that may be put. Hence the importance of formulating precise inquiries from which to judge, instead of making a purely general inquiry that can usually be evaded. This remark applies even to bank references. The author recalls a case in point, where a bank had foreclosed upon a factory under a mortgage, and put in a receiver to carry on the business pending a sale. The business was carried on at a loss, and for a long time no purchaser could be discovered. Had the business been shut down, and the assets sold piecemeal, the bank would have had to admit a very considerable loss on that account; but eventually they were able to arrange with another of their customers to take over the factory, upon the terms that they lent to him the whole of the purchase-money required at a very low rate of interest, in consideration of his giving them (as further security) a mortgage over his own factory. The bank thus improved their position to the extent that (1) they changed a dead account into a living one, and (2) they got additional security; but there could be very little doubt that the venture was beyond the means of the second customer who bought the business. He was undoubtedly over-trading in taking it, and undoubtedly no other bank would have lent him the money on that security. In such circumstances one cannot help thinking that, had this manufacturer been asked to furnish a banker's reference as a condition of getting accounts opened with new business houses for the supply of materials, he would have got a very good reference from his bankers.

If they were not prepared to give him a good reference in response to inquiries, it was obvious that he could not carry on the business, and therefore that they would be in much the same position as before.

Organisation of Credit.—Speaking generally, in all save cases where credit is limited to a stated (small) sum, inquiries of some sort must be made before authority is given for credit; and, of course, to enforce a rule like that effectually some one must be made personally responsible for seeing that it is carried out. That means that matters must be so organised that no new account can be opened—no order from a new customer accepted—until it has been passed by the head of the credit department; and he in his turn will be governed by regulations requiring him, if he authorises credit for more than a prescribed maximum, to make certain prescribed inquiries. In the interests of efficiency one must see that the result of these inquiries is placed upon record, as being the justification for authorising the credit. In many cases it will be found the most convenient arrangement to deal with information of this description in the form of a Card Index, with a separate card for each new account opened, showing what inquiries have been made, and what (briefly) has been the result of those inquiries, and the extent of the credit authorised in consequence. In that way one can accumulate, and systematise, evidence justifying the authorisation of credit, and (in the absence of such evidence) it is to be assumed that there is no justification, and that the head of the credit department has exceeded his duties. It is important to bear in mind that credit may be limited in two ways—in amount, and in point of time.

Credit Indexes.—Now, having got matters up to the point that no new Debit Accounts are opened without the specific authority of the Credit Department, we may consider what steps are necessary to see that the account opened is only operated upon within the limitations authorised. This, of course, involves the limitation of credit authorised being communicated to the Ledger clerk. The Card Index arrangement already mentioned is a convenient means of arranging this, because the same Card Index may be made to serve as an index of the Debtor's Ledger. There is not, as a rule, any practical difficulty in the way of that; but, of course, if it should be inconvenient, because the two staffs are not placed sufficiently close to each other to work from the same Card Index, then, of course, the record must be duplicated. But, however, that may be, the authorised limit of credit, both as to amount and as to time, should be stated at the head of the Ledger Account or in the Index. Unless one is going to save work by utilising the Card Index compiled in the Credit Department—if the work has to be duplicated—the balance of advantage seems to be in favour of these limitations being placed at the head of the Ledger Account, because they are thus brought prominently to the notice of the Ledger clerk each time he refers to the account of the customer; there is then little excuse for the limitations being exceeded without the fact being promptly reported. The risk of the limit being exceeded is, perhaps, greatest in the event of accounts becoming overdue. One may reckon that a £50 limit will justify the passing of orders to the extent of (say) £20 per month, having regard to the conditions under which accounts are rendered, and if

the accounts are promptly paid upon that footing, one may be quite sure that the total amount owing will then never exceed the prescribed total of £50; but directly an account is not paid when due, the position, of course, becomes complicated.

Overdue Accounts.—It is a good plan, therefore, either to arrange that each Ledger clerk shall, as a matter of course, report all overdue accounts to some prescribed authority—preferably *not* the head of the Credit Department, so as to introduce some one who may be regarded as a check upon him. Directly an account is overdue—or at all events if it is sufficiently overdue to recognise it as overdue—it is a very good plan to arrange that the machinery for applying for payment shall be shifted. If the normal arrangement is that customers remit on prescribed dates, then, if the account is overdue, the alteration in machinery might take the form of a written application for payment. If it be customary to send round collectors to apply for payment of accounts, then, when an account is overdue, it will be a good plan to shift it on to another collector. This shifting has the advantage of at once detecting any irregularities on the part of the collector, and provides a corrective for what is perhaps a greater risk, that, owing to slackness, or a partiality towards that particular customer, a collector may have failed in his duties without having committed any actual dishonesty.

Collecting Machinery.—It is only in quite a large concern that this shifting is practicable at an early stage; but, sooner or later, it will, of course, become inevitable if the account remains unpaid. If the account remains unpaid in spite of repeated applications, some more

energetic steps must clearly be adopted. An intermediate stage sometimes employed, particularly in connection with industries where there is a well-organised status inquiry agency, is to place overdue accounts in their hands for collection. This, of course, is merely one form of the plan just recommended, a change of collectors; but, if that fails, recourse must of necessity be had to legal proceedings. With a large concern, having a large number of overdue accounts, it may pay to organise a special law department, employing a qualified solicitor (or several qualified solicitors) to conduct the necessary legal proceedings. If so, here again there is a shifting of collectors. Alternatively, professional solicitors may be instructed for each particular item as it arises, and that again amounts to much the same thing.

Method of Record.—But, whatever the precise method may be, it is important to frame the records so that there is no uncertainty as to the department (or firm) in whose hands the collection of each debt may be. When working upon quite a small scale, it may be sufficient to place the matter upon record by a pencil note attached to the Debtor's Ledger account. Clearly, however, that is a makeshift sort of contrivance that will not answer very well upon an extensive scale. The only practical alternative is to transfer these overdue accounts into a special ledger, indicating the department (or firm) in whose hands the collection has been placed. Then one can look to that department—or that firm of solicitors, or that status agency, as the case may be—for the collection of all the debts appearing in that particular ledger. In this way a business house can keep effective control over its collectors, and incidentally build up a

record (which may prove very useful in the future) of those customers who have given considerable trouble from time to time. Such a record would greatly add to the value of any answers that might be given to status inquirers. It would also be handy, particularly in certain retail businesses, in cases where customers occasionally turn up some years afterwards, and thus an opportunity arises of again applying to them for payment of overdue accounts, which may perhaps in the meantime have been written off as bad. If the loss through Bad Debts amounts to anything considerable, a little money spent upon organisation in this way will doubtless be money well spent; more particularly because it is work that can, as a rule, be done more or less in one's slack time, and not work which is obliged to be done at the prescribed moment.

CHAPTER XIV

INSOLVENT DEBTORS' ACCOUNTS

Insolvent Debtors.—In the preceding chapter were considered the best methods of organisation, with a view to securing the prompt collection of debts due, and that necessary co-ordination between the selling department and the collecting department which is so important if preventable losses, through giving credit in unwise directions, are to be avoided. It is now proposed to carry the inquiry on this point—which is, after all, a very important one—further, by considering how best to deal with accounts where it is impossible to secure payment by the ordinary means, and one has therefore to make the best of a bad bargain, in the way of making some arrangement with an insolvent debtor—or a debtor who is so embarrassed as to be unable to pay his debts as they become due, even although he may not actually be insolvent at the time.

Reliable Records required.—At the outset it seems desirable again to point out the importance of reliable information—not merely as a record of the past, but also as a guide to the future. It is practically impossible for any one to do a credit business without occasionally incurring loss by way of bad debts; but this merely

emphasises the importance of thoroughly reliable records as to what these losses have been, so that one may at least have a chance of turning unprofitable experiences to good account, and thus avoiding a repetition of the same mistakes. To enable this to be done it is important that those records that are kept should make no confusion between losses arising through the financial failure of debtors—through their inability to pay that which is legally due—and losses written off because it is found impossible to substantiate a legal claim, or because it is thought better to waive a claim than to incur the trouble, expense, and enmity that legal proceedings would involve. As bad debts are practically inevitable in every credit business, so also to a certain extent are allowances. Items will occasionally be charged up against customers that are disputed for one reason or another, and it is sometimes thought desirable to write them off as "bad," either because they are legally irrecoverable, or because it is not thought worth while to assert one's legal rights; it is, however, very important to keep an entirely distinct record of losses involuntarily incurred through the financial failure of debtors, and of amounts written off which for all practical purposes represent cases of admitted overcharges or voluntary concessions. As a question of account, overcharges and allowances should be recorded as a deduction from the output, or sales, as a purely corrective entry; and all percentage figures that are prepared in connection with the accounts should be framed upon the basis that these allowances, or overcharges, are deductions from the gross output of the business. Loss by way of bad debts, however, comes under an entirely different heading. It is not a

loss for which the trading (or manufacturing) department can in any way be held responsible. So far as any one is responsible for the loss, it is the head of the orders department, or of the credit department, which, upon the organisation suggested in Chapter IV., will be under the control of the Treasurer.

Organisation.—Theoretically—following the general rules already suggested—it might seem desirable that, directly a failure occurs, the matter should be taken out of the hands of the department originally responsible for authorising the credit, and handed over to another department altogether. In the case of a very large business it is just possible that this might be a convenient arrangement, but in the majority of cases one gains nothing by attempting to departmentalise too much. There is, in practice, always the possibility of the main facts being overlooked, or suppressed; and the staff competent to deal with the authorisation of credit operations seems the staff most likely to have the qualifications suitable for following matters up in connection with failures. At all events the same chief will clearly be the one who will have to supervise both sets of operations—the financial chief of the business, by whatever name he may be known. In important failures he will probably find it worth while to do much of the necessary supervision personally; in comparatively unimportant ones he will delegate the work to others coming under his general supervision, and thus will be able to train up a staff of assistants really competent to help him in his work, and if necessary to keep it going in his absence.

Classes of Failures.—Failures come to the creditors' notice in two ways. Either the debtor comes to them

on his own initiative, and frankly tells them that he cannot meet his liabilities ; or the position is brought home to them that he is not paying his accounts as they become due, and then, when they bring pressure to bear upon him, they force his hand, and themselves precipitate the formal failure. These two different methods of approach are mentioned because they involve a slightly different handling of the matter in its initial stages, although probably the ultimate results are very much the same in each case.

The Largest Trade Creditor.—If an insolvent debtor comes to any of his creditors on his own initiative, he will probably do so because they are amongst the largest of his creditors, and he therefore consults them first because he hopes to get some sort of assistance or support from them by so doing ; failing that, he will probably make the announcement to all his creditors simultaneously. Here again one gets a slightly different procedure in the introductory stages. It is usual for a debtor who expects, or hopes for, anything in the way of consideration from his creditors, directly he finds himself unable to pay his debts as they become due, at once to go and see his largest trade creditor. Such is the custom in the City of London, and, upon the whole, there is a good deal to be said in favour of it, particularly from the point of view of the trade creditor. It means that, instead of dragging on to the last moment, until there are no assets left to divide, the debtor knows his position is clearly one calling for extreme measures, and accordingly takes the largest and most important creditor into his confidence, and agrees to do what he may be told. At this stage there ought really to be no legal

proceedings pending against the debtor—at all events he ought to be well ahead of the stage when there are judgments being followed up by executions. The custom is for the largest trade creditor so approached to nominate a firm of accountants to make an investigation of the debtor's books, and to prepare a statement of his affairs to be submitted to a meeting of creditors convened at the earliest possible moment. It will be seen, therefore, that although the largest trade creditor gets the earliest information, the practice is based upon the assumption that he will not use it for his own personal advantage, but with a view to ensuring that the creditors, as a whole, are called together as soon as possible, to have placed before them a reliable and impartial statement of the financial position. On this theory the practice is very clearly justified; and, doubtless, it is a good practice which stipulates that the largest *trade* creditor shall be approached, rather than the largest creditor, for the largest creditor, if he be not a trade creditor, is probably a creditor for money lent. A creditor for money lent is probably either a professional moneylender or a relative of the debtor, and in either of those cases there is not the same assurance that the statement of affairs submitted has been prepared in the interests of creditors generally. But, of course, there is always a certain amount of risk necessarily incurred when one creditor is approached in advance of others. It means that if he thinks of himself first, and abuses the confidence thus placed in him, he will have opportunities of getting advantages at the expense of other creditors, and in practice it is perhaps a little difficult to say precisely what is legitimate in that connection and what is not

legitimate. It is clear, for instance, that the creditor, knowing the position, is justified in refusing to supply any further goods to his debtor. One can hardly expect him to be quixotic enough to do anything else but cut off supplies. But, supposing the debtor has had goods on approval, it may be that in the event of a subsequent bankruptcy, these goods—which in law are in the apparent ownership of the debtor—would be held to be part of the assets of the bankrupt, and there is then a strong temptation, of course, for the creditor to get them back. Sometimes, also, there may be a temptation for the creditor to discourage the calling of a meeting, or the advising of the other creditors as to the position; being most heavily committed himself, he may tell his debtor that he is taking too pessimistic a view of things —that he ought to hang on a little longer, and hope for better trade in the near future. In the meantime he perhaps takes very good care to supply no more goods himself. If the debtor can secure goods from others in the meanwhile, even if the principal creditor gets no further payments on account, he has benefited, because, in an insolvent estate, if an equal amount be added to both assets and liabilities, the dividend likely to be paid to the creditors is increased—although, of course, not to the full extent of the difference, because the new goods are hardly likely to be sold at their cost price. It will certainly be to the advantage of the creditor who supplies no further goods, that as many more goods as possible should be secured from the remaining creditors. So this rule, excellent as it no doubt is in the generality of cases, and safe as it no doubt is when applied to reputable houses, is capable of very serious abuse under

other conditions; and that is a point not to be lost sight of by creditors when they have to consider the position of a debtor's affairs eventually—as to whether an undue, or unfair, preference has been given to some creditors who knew the true position of affairs before they did.

Private Arrangements.—In the majority of cases, when creditors are called together to consider the affairs of an insolvent debtor, they will prefer to come to some arrangement with the debtor outside of the bankruptcy laws. There are various reasons for this, which may, however, probably all be summed up in saying that it pays them better. The procedure in bankruptcy is much more complicated, more costly, and more lengthy than procedure under private arrangements; and although bankruptcy possesses certain advantages (to which attention will shortly be drawn), unless it is necessary to have recourse to these advantages, there is nothing to compensate for the disadvantages already mentioned. But there is another reason for trying to avoid bankruptcy, if possible, besides economy and despatch, and that is, that in the majority of cases a debtor can get some friends or relations to help him, if he is not pressed into bankruptcy. He will usually find some one willing to lend him money to help him to effect a settlement with his creditors, or some creditors willing to allow the payment of their debts to be postponed until the claims of general creditors have been settled with; and either of these arrangements is enormously to the advantage of the general body of creditors—an advantage which can, as a rule, only be secured by refraining from bankruptcy proceedings. The disadvantages of these private arrangements are that, to a very large extent, it is

necessary to assume the *bona fides* of the debtor ; beyond the somewhat limited inquiry that it is possible for the accountant nominated by the largest trade creditor to make, there is nothing whereby to test the debtor's statements ; further, unless all creditors agree to the arrangement, there is no assurance that the affair may not drift into bankruptcy after all. If it is bound to drift into bankruptcy, then, clearly the sooner the bankruptcy begins the sooner it is likely to be finished ; so that, unless there is every reasonable likelihood of creditors all agreeing to an arrangement, it is mere waste of time to have anything to do with it, however desirable it might be in itself. As a rule, trade creditors will agree to an arrangement ; the smaller creditors follow the lead of the larger ones, and the larger ones, as far as practicable, satisfy themselves that it is the best thing to do. But money-lending creditors are not always so easily conciliated. Also "incidental" creditors are much less likely to treat an insolvent debtor with consideration than creditors who have been dealing with him for years, and have made money out of him in the past. A man, therefore, who claims to be a creditor as the holder of a Bill of Exchange under which the debtor is liable, unless he has had regular business transactions with the debtor, is not, as a rule, very likely to assent to a private arrangement. Of course, all depends upon the circumstances of the case ; but, speaking generally, he will be a most difficult creditor to conciliate.

Retention of Business Connections.—One has also to remember that, so far as trade creditors are concerned, they would be taking a narrow view of matters, if they considered solely the question of how much

money they could hope to get in satisfaction of their respective claims. That is one point they have to consider: another point is that, with the failure of this customer, their connections are accordingly restricted, their facilities for securing a market for their output are reduced. What can they do that will help to keep this market for their output in existence? Of course one has to very carefully consider the expediency of keeping upon his feet a debtor who has already failed, merely for the sake of retaining him as a customer for the future. Unless a trader adopts a very cautious policy with regard to such matters, the probability is that he merely multiplies bad debts; but, on the other hand, it certainly would be unnecessarily cautious to make a hard-and-fast rule, never again to do business with a customer who had had to make an arrangement with his creditors. In considering such arrangements, therefore, the trade creditor will always take into consideration the possibility of doing further business with the customer, and the desirability of doing such further business.

Incidental Creditors.—The incidental creditor has no such interests. All that concerns him is to secure the largest dividend he can, and thus to reduce his loss by way of bad debts to the smallest amount possible. Therefore the incidental creditor is more likely than the trade creditor to be hostile to the honest, but unfortunate, debtor. If there are many such incidental creditors, the prospects of carrying through a private arrangement are almost hopeless.

Control of Proceedings.—It would, of course, be quite outside the scope of this work to attempt to go into details

concerning the numerous and highly technical points that arise in connection with bankruptcy procedure. In the vast majority of cases business men are guided in these matters by their professional advisers. Many large firms have a standing arrangement with some firm of accountants, under which they agree to advise them in all insolvency matters free of charge, in consideration of getting their support (wherever possible) for appointments as trustee in bankruptcy or under a private arrangement. So long of course as reputable firms of accountants have been employed, that is an arrangement which works well in practice; and it has the advantage of being economical, in that it involves no direct expense. Very large firms employing qualified solicitors on their staff may prefer to remain unattached, and to rely upon their staff solicitors for that skilled advice which they no doubt will require from time to time. It is largely, of course, a question of weighing up relative advantages and disadvantages; but, assuming an arrangement can be made upon the lines indicated with a thoroughly trustworthy and experienced firm of accountants, the probability is that it will be at once more satisfactory and more economical.

Bankruptcy.—Now turning to the other form of arrangement with creditors—bankruptcy. Bankruptcy is a state of affairs brought into existence by law, under which the property of an insolvent debtor is automatically transferred to some one appointed as a trustee for the benefit of creditors generally. A bankruptcy may be brought about either by the debtor himself applying to be adjudicated bankrupt, or as a result of pressure brought to bear by creditors. It has various

advantages over private arrangements in certain cases which it is decidedly important not to overlook. First of all, in bankruptcy, it is open to the trustee to scrutinise all payments made by the debtor shortly before his failure, and in any cases where he has made payments to creditors with the object of preferring them to the creditors generally, the monies so paid away may be recovered. Secondly, in cases where the debtor has given away his property, without reasonable consideration in exchange, at any time within the last two years it may be recovered. This of course does not refer to trifling presents of no importance, but to substantial sums conveyed or settled by deed. The settlement or conveyance may be set aside, if it has taken place within two years before the commencement of the bankruptcy; or even in the case of ten years, unless the debtor can show that at the time he was solvent without taking into account the property that he alienated. Thus all sorts of fraudulent, or unscrupulous, subterfuges on the part of debtors may be brought to nought in bankruptcy, provided of course a competent trustee is appointed to deal with matters. Then again, in a private arrangement creditors are obliged for all practical purposes to accept the statements made by the debtor or else to have nothing whatever to do with him—in which case, of course, the private arrangement falls through. In bankruptcy they may require those statements to be made on oath. The trustee may cross-examine the debtor as to their accuracy; and, not only that, he may summon either the debtor (or any one else whom he may think likely to serve his purpose) before the Registrar of a Court having bankruptcy jurisdiction, there to

be examined on oath as to his connection with the bankrupt's affairs. Even if the result is not to find anything incriminating, the expense is limited to the trustee's own expenses and a very trifling allowance to the witness examined; it is an entirely different thing from bringing an action against some one and losing that action, and having to pay expensive law costs to the other side as well as his own. Thus in bankruptcy there are many highly effective means of really getting to the bottom of things, which are altogether missing from private arrangements; in cases of suspicion, therefore, the probabilities are that it is wiser to adopt the more complicated procedure, unless of course such an offer is made by the debtor as to make it worth while for the creditor to say that he does not much care whether the debtor has been trying to swindle him or not. Naturally these inquiries in bankruptcy necessarily involve a certain amount of expenditure, and if a fraudulent debtor has swindled his creditors very thoroughly, and left absolutely no assets to come to the bankruptcy trustee, then unless the creditors are prepared to form a fund to cover the costs of an inquiry, it is hardly to be expected that any very searching inquiry will be undertaken. This is one of those cases in which it does not pay for a man to do things by halves. If a debtor is going to try to defraud his creditors, it would be unwise in the extreme for him to leave any assets in the bankruptcy to pay expenses for tracking frauds right through to their sources.

Insolvent Companies.—Assuming the insolvent debtor, instead of being an individual or a partnership, is a limited liability company, then of cyurse, there being

limited liability, the customer may be insolvent although all the members of the company are very rich people. One cannot then bring pressure to bear upon the customer by threatening bankruptcy. There is no disgrace to a man, because he has lost the money that he invested in a limited liability company. It is no good, therefore, to try to squeeze him into making an arrangement advantageous to creditors; but it may be that the shareholders will think it worth while to try and put the company on its feet again, although they are not liable to pay its debts if they have already paid for their shares in full. If they think that the company's business has a future before it, they may be unwilling to lose the money they have already invested without making some further effort. That of course gives the creditor a chance to come to some arrangement with the shareholders; because, if the shareholders want to continue the business, they will have to purchase it from the liquidator of the company, who roughly corresponds to the trustee in the bankruptcy of individuals. The analogy is, however, only approximate, because there are a number of rather important discrepancies which it seems unnecessary to go into here, as they do not affect any one except the liquidator, and those primarily doing business with him. One point of difference must be mentioned, however, as being of importance from the point of view of the present inquiry—that during the winding-up of a business very commonly the trustee (or liquidator, as the case may be) will have occasion to buy further goods to carry it on: in the case of a trustee in bankruptcy, he will be personally liable to pay for all goods that he orders unless he has made

express arrangements to the contrary. In the case of the liquidator of a company, unless he has agreed to be personally liable he is not so liable—the liability is a liability of the company, and the liquidator is merely an officer of the company, in the same way that the directors and the secretary were officers before him. That is, of course, an important distinction, suggesting that creditors supplying goods to a company in liquidation should satisfy themselves that there will be sufficient assets to pay for those goods in due course. In a bankruptcy case all that one has to inquire into is as to whether the trustee is a man of sufficient substance to pay for the goods.

Reconstructions.—In company matters one may get something roughly corresponding to a private arrangement, in the form of a general reconstruction of the company, when creditors may be paid an agreed composition of their respective claims; or they may perhaps be satisfied with Shares, or Debentures, in the new company as payment. If they are wise, however, they will as a rule prefer cash.

Liquidations.—The procedure more nearly corresponding to bankruptcy is what is called the liquidation, or winding-up, of the company. This may take one of three forms—a voluntary liquidation, where the liquidator is appointed by the shareholders and subsequently approved by the creditors; a compulsory liquidation, where the liquidator is nominated by resolutions of shareholders and creditors at separate meetings, and in the event of their not agreeing is appointed by the Court; or a voluntary liquidation under the supervision of the Court, which follows much the same lines as a voluntary

liquidation, save that the Court may appoint one or more liquidators either in place of, or in addition to, the then existing liquidators. In any case the powers of the liquidator correspond for present purposes very closely with those of the trustee in bankruptcy. There is ample power of inquiry, and ready means of proceeding against the directors and other officers who have misapplied the monies of the company; but a compulsory liquidation is more costly and more protracted than a voluntary liquidation, and therefore as a rule the voluntary liquidation is to be preferred. In all save the most exceptional cases a late director, or late official, of the company is not a suitable person to be appointed liquidator of that company, if it be insolvent; because, in the event of insolvency, it is desirable that there should be inquiries made which, in that case, would practically be inquiries by the liquidator into his own past conduct.

The Problem for Creditors.—Whether a debtor be an individual or a limited liability company, the problem before creditors really resolves itself into one involving two main considerations: the first is, how can they escape with a minimum of loss by way of bad debts? and in that matter they have to remember that time is money, and a prompt payment may therefore be much more advantageous than a larger payment made years later; and secondly, they have to consider what they can do to avoid the shrinkage of their connections that will result from the dropping out of business of one of their customers. These two points ought in all cases to be carefully considered, and no decision should be come to on the one without considering the other at the same time; but it would be extremely bad finance to attempt

—as is sometimes done—to bolster up the credit of an insolvent debtor for the sole purpose of securing a continuance of orders, unless there is some very reasonable assurance that the creditors shall not be losing more in the long run than if they were to cut the loss now and have done with it. Other things being equal, the first loss is undoubtedly better than the last loss, for it saves the expenditure of a great deal of time and energy that would otherwise be involved; but if one can clearly see an advantage in keeping a debtor going, then it may well be worth while to admit a present loss by way of bad debts, accept a composition in settlement, and write off the difference as irrecoverable, if by so doing one can cement one's connections and keep a customer as a source of future business of a profitable character. Of course, if the creditor is not proposing to continue in business, then the question of the future of the customer ceases to have any practical effect; but in a continuing business it is sometimes a very material consideration, although even here one must not go so far as to treat it as being the only matter of importance. It is always possible to secure orders, if one is willing to accept them without making proper inquiries into financial status. *Primâ facie* a regular customer who has failed is not a desirable customer for the future; but it is a case with so many exceptions that it is certainly not worth while to lay down any hard-and-fast rules of that kind. Each separate case must be considered on its merits.

CHAPTER XV

CO-OPERATION AND PROFIT-SHARING

Preliminary.—In connection with the study of "Business Organisation," it is necessary to stay upon the fringe of a variety of outlying subjects, and it is thought that Co-operation and Profit-Sharing come under that heading. Anything approaching an exhaustive study of either title would come under the category of Economics or Sociology, rather than Business Organisation; but it seems desirable at all events to consider these matters in passing, with a view to determining whether they represent—or may, under favourable circumstances, represent—a practical method of increasing efficiency; and, if so, upon what lines it is most likely that they could be carried to a successful conclusion.

Co-operation.—In this connection it seems quite possible that Co-operation is really outside the present scope altogether, in that it rests upon an entirely different basis to ordinary commercial business. Co-operative undertakings—if they are really co-operative undertakings, and do not merely make use of the name as a means of attracting customers who may hope to be able to buy goods at a cheaper price—co-operation is a mutual combination of some particular class of persons, with a view to enabling them collectively to supply their wants—or

certain of their wants—as individuals. A mutual insurance office is in this sense an example of co-operation; but the term, as usually employed, represents rather some combination of those who—for want of a better name—are usually called "the working classes," to enable them to buy (or manufacture, or sell) goods without the assistance, or intervention, of other classes. It is an attempt on the part of these working classes to be self-sufficing, or at all events self-sufficing up to a point. Such capital as may be required for the venture—and of course it goes without saying that capital is required for all business ventures—is ordinarily supplied by the members themselves, who are also the customers (or the manufacturers, or the traders, or some combination of all three) upon such terms that, while it remains in the business it is entitled to a fixed minimum rate of interest, is withdrawable at comparatively short notice, and carries with it certain rights to a bonus out of profits. Subject to the rights of capital to participate in profits by way of bonus, profits are divided among customers (or workers, as the case may be) so that each gets, or is supposed to get, what may be called "a fair share" of the profits earned.

Weak Features of Co-operation.—The weak features of the system from the point of view of business organisation are, in the first place, that if the attempt is made too exclusively a "class" movement, it will probably be found difficult to secure the necessary "brains" to direct the enterprise to the best advantage. That is a difficulty that will not, of course, always be experienced in practice; but if one deliberately limits one's self in the selection of suitable employees by making stipulations of this kind,

one makes the task of selection correspondingly more difficult. The second drawback is perhaps more serious. In the majority of cases, at all events, those combined together in this way are persons of small capital: that is to say, their accumulated wealth is small in itself, and small as compared with their annual earning capacity. It would probably be framing a generous estimate of their accumulated wealth if one were to say that it averaged two years' income. Now, those who have comparatively little capital, if they invest in business, no matter how prudently that business may be conducted, they will sooner or later come across barren years; it is impossible for any business, carried on for an extended period of time, to avoid coming across periods when it is difficult (if not impossible) to make a profit. "Profit" in this case is hampered with a charge by way of interest; also by the expectation that bonuses will be paid from year to year, and the fear that, if bonuses are not paid—or if they fall below the accustomed level—irreparable damage will be done to the business by the loss of regular customers. There is thus a strong temptation in bad times to strain a point, in order to continue the payment of bonuses. If the bonuses are paid when they cannot be justified by the profits, sooner or later the result is bound to be that the undertaking gets into financial straits. If, on the other hand, customers are lost through failure to keep up bonuses, the same position is very likely to be brought about. There are similar risks, of course, in most business concerns, to the extent that shareholders ordinarily expect the payment of regular dividends; but there is this important difference, that in co-operative societies, if the members are dissatisfied,

they can withdraw their capital at short notice. If the members of a limited company, registered under the Companies Acts, are dissatisfied, all that they can do is to sell their shares. They cannot go to the company and demand their money back. The result is that these Co-operative Societies are in a position of "unstable equilibrium." They are liable to have large demands made upon them for the repayment of monies just at the times when it is most inconvenient to make repayment. Demands are the more likely to be made in such cases by reason of the fact that these members, having in general not too much capital at their disposal, are much more likely to be timid about the possibility of losing it than other classes, who can perhaps afford better to sustain losses in bad times.

Extent of the Movement.—For these reasons it seems hardly likely that any very extensive increase of the co-operative movement is in store, at all events upon existing lines; but, for all that, the movement is one not to be left out of account when it is borne in mind that the membership of these societies at the present time amounts roughly speaking to $1\frac{3}{4}$ millions, as against $1\frac{1}{4}$ millions some fifteen years ago, and that in the same time their aggregate sales have increased from $50\frac{1}{2}$ millions to $68\frac{1}{2}$ millions. Co-operation is therefore an organisation that is being carried on upon no insignificant scale, and one which is at all events well worth watching, as showing possibilities of development that are worth considering, and—perhaps in part adopting—by other concerns.

Profit-Sharing.—Profit-Sharing stands, however, upon an entirely different footing. Instead of representing

businesses created by workers joining together without the assistance of the capitalist classes, profit-sharing represents what may be regarded as being the retort put forward by the capitalist classes as an alternative—and in their opinion in every respect a better alternative—to co-operation among the workers themselves. It represents, in general terms, some arrangement under which the workers employed in a concern (or some appreciable proportion of those workers) receive, in addition to their salary or wages, some advantage—immediate or prospective—payable out of profits when net profits are earned. The term "workers" must here of course be construed very widely, as covering all kinds of employees, and not merely those of the artisan or labouring classes.

Past Experiments in Profit-Sharing.—As a movement profit-sharing seems to date practically from the French Revolution of 1848, but there is at all events one instance of profit-sharing in this country as early as 1829. Regarded as an organisation, it is still quite unusual; but upon the whole, it seems to have produced effects that are at all events sufficiently encouraging to warrant further attention being given to the matter. Up to a comparatively recent date there were 101 cases of profit-sharing known to be in existence in this country, and a further 51 known to have been started and to have been discontinued. The earliest of these dates back to 1866, but the largest number was in 1890, when 32 cases were instituted, of which 21 are still in existence. These figures are so small—so insignificant as compared with the whole volume of the business of this country—that it is very easy to attach an altogether exaggerated

importance to any conclusions that might be drawn from them; but still it is worth while to consider shortly the different classes of occupations to which profit-sharing schemes have been applied in the past, because clearly such schemes are not equally suitable to all occupations. In drawing attention to these figures, however, it seems desirable to remind the reader that when one is dealing with such very small numbers, the merits of the individual scheme probably has more effect upon its success than the nature of the occupation itself. Still, for what it is worth, it appears that, of these 152 cases, no less than 22 schemes related to the printing trade, of which 18 are still in existence; 21 to metal manufacture, of which 11 are still in existence; 14 to the provision trade, of which 13 are still in existence; 13 to agriculture, of which 8 are still in existence; 8 to the clothing trade, of which 2 are in existence still; 8 to textile manufacture, of which 5 are still in existence; 5 to the building and decorating trade, of which only 2 are still in existence; while in the remaining cases the numbers are so small as to be hardly worthy of consideration. It will be seen, therefore, that, as far as it goes, it would appear—if one may rely upon these figures as being representative—that the system, as a system, does not appear to be particularly successful in connection with metal manufacture, or agriculture, nor yet in textile trades; but that in the printing and provision trades a considerable majority of those schemes instituted have been permanent.

Alternative Schemes Outlined.—Turning to profit-sharing schemes themselves, it is not easy to classify them, because in a sense almost every scheme differs in some detail from every other scheme; but for general

purposes the classification adopted in the Board of Trade report on Profit-Sharing of 1891 is as convenient as any other—and it may be mentioned that those who are interested in the subject will do well to read that Report, for although it is now somewhat old, it can hardly be said to be out of date. Profit-sharing schemes are there classified under four headings: First of all, those schemes where a share of profits—not necessarily any fixed share, but a sum out of profits—is paid over to the workers (or to some portion of the workers) at the close of the year, by way of a gift or bonus—not necessarily divided in any previously agreed ratio, but a purely voluntary payment which it is understood may be looked for in successful years, depending entirely upon the employers' sense of what is fair as between employees. Such a scheme is, of course, so unsystematic as to be hardly worthy of being classified here at all, were it not for the fact that it so usefully paves the way for more highly organised systems, by preparing a staff for something more carefully worked out and less liable to give dissatisfaction owing to the casual mode of distribution. The second class is where a definite proportion of the profits is paid over to a Provident Fund, applied in some way or other for the benefit of those entitled to participate in the scheme. In such cases usually the workers are only entitled to claim against the Provident Fund after a stated, and somewhat lengthy, number of years' service, or on attaining an age suitable for superannuation; or it may be that their relatives have a claim on the fund in the event of their death. Thirdly, there is the system which provides for a specified share of profits being allocated to the benefit of the workers in such a

way as to assist them in becoming joint owners of the business. This may take the form of distributing bonds which carry interest at a specified rate ; or it may take the form of distributing monies applicable to the purchase of shares in the business, if it be a company ; or, in certain cases, the directors have arranged to lend money to the workers wherewith to buy Shares in the company, have charged them a low rate of interest on such loans, and have applied the surplus profits towards the gradual repayment of the loans. However the system may work out in detail, its practical aim in all cases is the gradual transference of the ownership (or part ownership) in the business to the workers, or to a selected number of such workers ; it differs, therefore, somewhat fundamentally from other schemes, in that it aims—as far as it aims at anything—at converting the working classes into capitalist classes upon a small scale. Whether that be a merit or a drawback to the scheme is, of course, largely a matter of opinion. The fourth class aims at distributing a stated portion of the profits among the workers in some definite and predetermined ratio, and in cash ; being therefore equivalent to the first scheme—a haphazard bonus scheme—but more highly organised and worked out as to details. In practically every case the share of profits allocated for profit-sharing purposes is arrived at after making a first charge on profits to represent interest on the capital actually employed in the business. That, of course, is only reasonable, provided the rate of interest is reasonable in itself.

Advantages to Employers.—As to the inducements that a profit-sharing scheme may offer to employers, it would seem that many of those who have tried it have

come to the conclusion that the share of profits thus set aside for distribution among the workers does not really come out of the employers' pocket at all, but represents merely payment out of an increased gain to the business as a result of the higher efficiency brought about as a result of the scheme itself. If that can be justified as a matter of figures, the scheme is, of course, abundantly justified as a financial expedient on the part of employers anxious to increase their income ; but, apart altogether from that, it may well in certain cases be to the advantage of employers to establish some such relationship between themselves and their workers, even if at the moment it does not seem to pay them. In the nature of things the success of such schemes, or their failure, ought not to be judged prematurely. One ought to see a scheme in operation over a long period of years—over a large cycle of trade—before judging as to its practical working. And this, of course, cuts both ways. The arguments in favour of such a scheme have been summarised in this way: it is said that additional profit is sure to arise because the men are more careful and there is far less waste of material, there is less need for superintendence, since the men keep a watchful eye upon one another, the general quality of the work turned out is improved, there is increased stability of the *personnel*, giving greater immunity from strikes and other labour disputes, and that the workmen are more ready to aid the management with suggestions as to improved methods of manufacture or as to means of avoiding waste. We may fairly admit the probability of some (or all) of these advantages being experienced in every case, and the higher the general level of education of the

workers, probably the greater will be the advantages. But on the other hand, as directly bearing upon the subject of Business Organisation, the following practical difficulties call for consideration. They are not any of them insuperable, but they are points that would have to be carefully considered in each case, and the success of any individual scheme would seem largely to depend upon the thoroughness with which they had been considered and dealt with.

Definition of "Profits."—First of all, all these schemes, except the first ("rough bonus" scheme) seem to involve a definite allocation of a certain share of "profits" to what may be called the Workers' Fund. Now, it is one of the most difficult things in connection with business matters to say what are the profits of a business for any stated period. If therefore an employer definitely promises to apply a stated fraction of profits to a particular purpose, he will merely be inviting disputes, if he does not either define what he means by "profits," or (if he cannot do that) settle quite clearly who, and who alone, shall be entitled to assess profits. It is impossible to define "profits." It is necessary, therefore, that the scheme should clearly indicate who are to be entitled to assess them, and provide that every one must absolutely abide by that decision. If the employer is going to determine what are profits, for all practical purposes that seems to get one back to the arbitrary bonus system. If one is going to promise to give a definite share of profits to a particular cause, one ought to provide that some independent party shall determine what are "profits" within the meaning of that agreement; and, bearing in mind that practically all those concerns

engaged in profit-sharing schemes will be public companies, a practical solution of the difficulty would seem to be to leave the determination of profits to the company's Auditor. But however that may be, some means should be provided of avoiding disputes as to what the profits to be divided really are.

Who shall Participate.—The next point where difficulty may well occur is as to who is to be entitled to participate in the scheme. In the vast majority of the schemes already introduced there seem to be only a quite limited number of participating employees. Employment in the business for five years, or upwards, seems to be a minimum kind of qualification; but it must necessarily exclude a very large number of employees. If workers be admitted to participation too cheaply, the employer is, of course, depriving himself of one of the strongest advantages of the scheme—its powerful encouragement to men to remain permanently in his employ. On the other hand, if he puts the qualification for participation too high, his scheme is capable of being criticised—whether justly or not—as a conspiracy to buy over a limited number of employees as spies in the interests of the master. The non-participating employees will probably consider that the funds divided among those who do participate have been wrung out of them by inquisitorial and unsportsmanlike methods. If one goes too far to that extreme, while one may have a fair number of very contented participating employees, one will nevertheless be going out of one's way to sow discontent among the remainder. From a common-sense point of view it would seem that, as far as possible, those employees who are capable of increasing the

divisible fund should be the ones entitled to participate in the distribution. Where to draw the line would, of course, depend largely upon circumstances, but in some cases a much longer period of service will be necessary than in others before employees can be really useful from this particular point of view.

If Workers Leave?—Then there is another point. The employer, of course, aims at encouraging employees to stop with him permanently; but supposing employees leave? If they are going to forfeit all benefits in the fund, it may create a very sore feeling which in the long run will not pay. Of course, the fact that these benefits (in so far as they have not been received in cash) are liable to forfeiture in certain circumstances, may be a very good weapon to hold over the employees. The risk of losing their pension is no doubt the consideration that has kept most of the employees in the Postal Department of Paris at their work during the summer of 1909, instead of joining the threatened strike; but it is a point to be considered in every case upon its merits, whether success won by such methods will pay in the long run—and, of course, it is only in the long run that anything is worth while.

Effect on Efficiency.—There is another point, of course, which certainly ought not to be overlooked, although the probability is that it is not likely to be applicable to many cases; if the workers are not capable of improvement—if they are unteachable—then it is difficult to see how the employer can benefit by any profit-sharing scheme. It is really only in so far as a profit-sharing scheme will enable the expenses of supervision to be reduced that there seems to be very much scope for

effecting economies that will place it upon a financially paying basis.

Mutual Confidence Required.—Next, one has, of course, to secure the confidence of the workers in the scheme. There must be every reasonable assurance that the privileges promised will not be arbitrarily withdrawn—at all events, not within a stated minimum time. No permanently good results could be expected, if the employers were to break faith, and withdraw, or seriously modify the scheme to their own advantage. And that suggests another point. Where the scheme consists partly (or wholly) of prospective benefits, what security should be given for the safety of the Provident Fund? *Primâ facie* one might be inclined to say that it should be invested outside the business in trustee securities in the names of trustees, thus giving ample security for their existence, whatever happens. There is no doubt much to be said in favour of such an arrangement, and it is at least worthy of consideration; but the whole object of a profit-sharing scheme presumably is to persuade the employees to help in building up a sound business on permanent lines. If therefore the Provident Fund be invested in the business, the existence of this fund depends upon the continued prosperity of the business. It is worth while considering whether in that way the employer is not more likely to achieve his purpose of stimulating the energies of workers to the utmost.

Effect of Bad Trade.—Lastly, there is the difficulty which in practice seems to have been the cause of the failure of most schemes that have failed, that one cannot ensure a succession of profitable years. It is true, of course, that employees are not dependent upon profits,

in the sense that the whole idea of these schemes is that normal rates of salary (or wages) are being paid in the first place in any event, irrespective of profits; that the profit-sharing fund is something additional, as a reward for exceptional effort. But, for all that, nothing is more easily acquired than a higher standard of comfort in mode of living. If, after three or four profitable years, an unprofitable year were experienced, the practical discomfort of the average employee would probably be almost as great as though, at the commencement of the scheme, he had been asked to submit to a corresponding reduction of pay. This really is a difficulty that can, it is thought, only be got over by applying to these schemes the same sort of principle that one applies to the payment of dividends to shareholders; that is to say, while a specified fraction of profits may be allocated yearly to the Workers' Fund, the payments out of that fund in cash should invariably be so much less than the payments into the fund as to enable sufficient accumulations to be made to tide over any likely lean period, thus securing uniform cash payments even in bad times.

Scope for Profit-Sharing Schemes.—With this modification, profit-sharing seems to be quite capable of development; and its possibilities of development are, as already stated, very much brighter where those entitled to participate in the scheme are men of resource, intelligence, and education, than when they are limited entirely to the labouring classes. Such schemes are by no means necessarily confined to manufacture or to commerce. They have been successfully applied in certain cases to trades also, and they are not unknown in other occupations of a more or less professional character. To these

last they are perhaps most suitable of all, because in those cases the capacity of the individual worker to curtail expenses, or to increase earnings, is probably much greater than in the case of larger concerns, where the individual is a mere unit working among scores, or hundreds, or even thousands.

CHAPTER XVI

THE ORGANISATION OF FLUCTUATING AND TEMPORARY BUSINESSES

Practically all Businesses Fluctuate.—It is now proposed to discuss some of the more practical points that arise in connection with business organisation, having regard to the fact that the volume of business transacted under ordinary circumstances is not a fixed quantity, but rather a fluctuating one. From this point of view businesses may be divided into four categories: (1) expanding, (2) contracting, (3) stationary, and (4) temporary; but it will, of course, be understood that any business—whether permanent or temporary—may, at various stages of its career, be either expanding, stationary, or contracting. Similarly a business which in the first instance was intended to be permanent, may—owing to some unforeseen event—become one which of necessity must be discontinued in the near future, and therefore from that date onwards rank as a temporary one.

Expanding Businesses.—So far as permanent businesses are concerned, the normal basis will be one that assumes at all events the hope of extension, more or less steady, and more or less indefinite. That, of course, means that from time to time in the lifetime of a permanent business

one will, as a matter of course, look forward to the necessity of increasing its capital, to enable it to cope with the increased volume of business; thus the problem of finance in connection with a new business, already referred to in Chapter III., is not one that in practice will really be settled once for all before that business is actually started, but rather one that will recur from time to time, and call for periodical reconsideration. But apart from this question of finance in connection with an expanding business, the mere fact that one is working up a business that one hopes will be permanent, justifies many things that would be quite imprudent in connection with a temporary business. Much of the expenditure reasonably incurred, and properly charged against profits from year to year, will be expenditure of a nature that is really largely intended to consolidate connections—to increase the output, and generally to build up a valuable Goodwill. Thus most expenditure coming directly or indirectly under the heading of advertising may be said to be incurred, in part at least, not merely for the sake of the immediate result, but also with the object of building up a solid and permanent reputation that can be drawn upon in the future. Clearly, as the business expands, so long as it is a profitable business, so will the value of its Goodwill expand. Similarly, in lean years the value of the Goodwill will to a certain extent automatically contract. The realisable value of the Goodwill will certainly contract in lean years; but, so long as the business is regarded as a permanent institution the realisable value of Goodwill (as well as the realisable value of all other Fixed Assets) is a matter with which one does not really want to concern one's

self. All that one has to consider in such cases, in order to be upon an entirely sound basis, is to make sure that the Fixed Assets which exist as a result of Capital Expenditure will be adequate for an indefinite period, provided only one continues to keep them "fed up" by judicious expenditure from time to time (charged against Revenue).

Of course the Goodwill, and the fluctuations of the Goodwill, are not the only — or even the most important—points to be considered in connection with the economics of a fluctuating business. Indeed, Goodwill in this connection is a matter chiefly of academical importance, apart from the point that, with a permanent business, one does not grudge expenditure that tends to consolidate the value of the Goodwill so long as it is not beyond the capacity of Revenue earnings to pay for it. But, apart from that, of course, if the business is to be at all permanent, and to produce anything like uniformly satisfactory results, one must look well ahead, or one will be working absolutely from hand to mouth, and run serious risks of increasing fluctuations by experiencing avoidable fluctuations as well as those that arise from extraordinary causes. The need to look well ahead is twofold. First, one wants to see where business is coming from—where one is going to find an output for one's goods or services, as the case may be; and, secondly, one must look ahead from the point of view of seeing how to meet the demands that may be made in the future for one's goods or services. If there is going to be any material increase in the output, there will have to be a (more or less roughly) corresponding increase of general equipment; but nothing like an

absolute correspondence between the two can be expected, partly because equipment cannot be added to so gradually as output usually expands, and partly because equipment can still less be reduced precisely as the demand for one's output becomes smaller. Thus although equipment must correspond to output, and it must be the endeavour of the skilful organiser as far as possible to maintain a balance between the two, under the ablest possible management one can never expect more than a rough correspondence—a somewhat sluggish response—and here, of course, there is scope for great difference of results according to the amount of skill that is brought to bear upon the matter.

Its Effect on Costs.—There is a very general impression that practically everything can be done upon a large scale much more cheaply than upon a small scale. Within limitations that is probably an accurate statement; but it is—like most other general statements—too general for accurate employment, and it is worth while therefore to consider what are its limitations: to what extent is it inaccurate to say that—whatever the nature of the product may be—one can produce more cheaply in large quantities than in smaller quantities. Now practically all costs of production come under three headings: (1) the cost of the inanimate materials; (2) the cost of the animate labour and supervision; and (3) the dead charges of general equipment. So far as the cost of materials is concerned, there can be little doubt that, up to a point, it is possible to buy more cheaply in large quantities than in small quantities; but when one comes to go into the matter a little further it is surprising how soon the limit of possible economy by buying in

large quantities is reached. It may easily be reached by comparatively small businesses. Very large businesses cannot, as a rule, be run more cheaply than moderate sized businesses of the same kind; but they may, of course, be able to economise by having several chances of disposing of those materials instead of only one. They will run probably far less risk of loss through depreciation of unsold stock remaining on hand; but the actual difference in the cost price of their materials will not be very great as a rule, save as between quite small concerns and moderate sized concerns. So far as the human element is concerned, up to a point a large concern will be able to secure all kinds of human work to better advantage than a small one; partly because it will be able to offer a more promising career to first-class men, and will therefore attract the pick of the market; partly because, working as it does in large numbers, it is able to vary those numbers so that they may respond more sensitively to the amount of work on hand in so far as it is prepared to substitute temporary workers for permanent staff. There will be some saving there on the part of the large concern; but the saving thus effected on what may be called the "subordinate workers" will probably be very largely overbalanced by an absence of saving—or even a relative loss—on the cost of supervision. The cost of supervision in a large concern will, in almost all cases, be a permanent organisation, and, as such, it cannot respond with anything approaching sensitiveness to a fluctuating demand. It comes more under the heading of dead charges, which go on year in and year out, whatever happens. With the small concern, on the other hand, where the proprietors themselves do a large amount of the supervision

and organisation, there is less risk of leakage if a limited amount of the cost of supervision be provided by temporary workers, as opposed to permanent staff; but the practical difficulty, of course, in relying on temporary workers for supervision purposes—or indeed for any other purposes—is that the time additional help is required is probably the time when everybody else with a similar business (or a somewhat similar business) will also be short of workers, and therefore the difficulty of securing desirable men will be proportionately increased, and the cost of obtaining them will be up. It is therefore always a question requiring a very nice adjustment according to the circumstances of the case, as to how far it is desirable to curtail expenditure in quiet times by reductions of staff. It is naturally a question that must be determined in each case upon the individual circumstances; but the larger the concern, and therefore the less the amount of the personality of the proprietors that is actually put into the business, the greater will be the need for a permanent senior staff thoroughly familiar with the rules of the house, so that in times of pressure, when every one is overworked, energy may not be unduly wasted in having to train strangers into one's own particular ways. With regard to standing expenses, one generally finds that, whatever the precise nature of the concern, it follows much the same rules in any usual form of manufacture. That is to say, it is found that, as a matter of experience, it is cheaper to manufacture a certain quantity of the commodity at a time, and equipment is arranged accordingly; but the quantity which represents what may be called the "maximum unit of economical production" is rarely very large. It

is usually quite within the capacity of the manufacturer in a comparatively small way of business; and the larger houses, instead of being scaled upon far larger, and broader, and grander lines generally, resemble more a collection of small factories working side by side. Probably there will always be some exceptions to this rule, some branches of activity where the larger undertakings can economise by working on the grand scale; but in the majority of cases they will be at little or no advantage, as compared with an aggregation of smaller concerns. On the contrary the mammoth undertaking is at this disadvantage probably, that its equipment is relatively more extensive in proportion to its output, because it is designed upon a bigger scale. Thus, to take the question of buildings: factory buildings may be said to cost so much per cubic foot; but the cost per foot will tend to increase the larger the building, so that the productive efficiency will not be in a constant ratio to the capital expenditure, but in many respects upon some sliding scale.

Necessity for Expansion.—But, for all that, if a business is to be a permanent one, one simply cannot afford to stand still. If the times are such that business is increasing, and a man attempts to keep his business stationary and to let orders go by, some one else is bound to get them. That means that some one else comes into contact with those who perhaps hitherto have been dealing exclusively with him; where he had for the time being what amounted almost to a monopoly of their work, or at all events a first charge upon their good offices, he has deliberately admitted others into a free competition. He may even have estranged his customers,

by placing difficulties in the way of their getting from him the goods or services which they had relied upon; so that every business which it is not intended shall be purely temporary must be willing to expand, if the need arises.

How Provided for.—Up to a point it can expand by what may be termed an increase of "pressure" on the part of all concerned, the human element working a little harder—part of it working overtime; part of it working longer hours, without perhaps a corresponding increase of pay. The machinery part of it can similarly be pressed up to a point; but only up to a point, and it would be a very nice thing to say whether the human element or the machinery element would be the first to give way, if too recklessly driven. As a permanent solution of the difficulty of too much business, extra pressure would be quite unsuitable; but it may easily serve to tide over a time of abnormal activity until the demand slackens, or until it has been possible to increase equipment. It must be borne in mind, however, that increase of equipment means that expenditure has to be incurred for weeks or months—perhaps even years—before that expenditure becomes remunerative. It is no good working absolutely from hand to mouth. Therefore, when a business is expanded, one naturally provides for yet a further increase; and the result is that, whereas before one had a compact works geared up to their fullest capacity, after the further outlay one has a larger concern capable perhaps of 20 or 30 per cent. expansion. The cost of production naturally is up. The immediate effect of an increase of prosperity, an increase of gross business, is to make demands for increased capital

expenditure, none of which will be immediately remunerative, and some of which cannot be utilised at the moment even when it is ready for use. Thus with an expanding business one finds these two things going on, more or less hand in hand: (1) a comparatively steady (but of course not absolutely steady) increase of gross revenue; (2) expenditure increasing more or less in jumps—with no direct correspondence between the two, unless one takes a very broad view extending over comparatively long periods.

Relation of Capital Expenditure to Output.—But although successful management will doubtless be shown, as much as anywhere, in adapting capital expenditure to current requirements, absolute correspondence between the two is never possible, and in general terms it may be said that an expanding business can never be conducted on the most economical terms possible. There must be a certain amount of waste.

Contracting Businesses.—With a contracting business, on the other hand, if once the fact be admitted that the contraction is more or less permanent, the problem is not one of capital expenditure, but rather of the abandonment of equipment (not necessarily a permanent abandonment of that equipment, but the closing down for the time being of certain sections of our undertaking, and the concentration of the work into those that remain.) If the contraction be permanent, the closing down will also be permanent, and will doubtless be accompanied by a realisation of discarded assets; if it be only temporary one would leave the equipment as far as possible standing, and only incur those expenses which were absolutely essential to prevent decay, and to keep necessary charges

going, such as rent, rates, etc. Now, here there is this point in favour of economical production, that one need never have a larger staff than is required for the day's work. If one foresee a continuous reduction of work, one can quite safely reduce the staff until that staff is really working at its maximum load, and yet feel safe that nothing will happen in the way of unexpected business to throw everything into confusion because one cannot cope with the work on hand. Of course, in practice one would never get quite this condition of affairs. However bad things looked, however certain it seemed that the business was a contracting one, one can never say for certain that next week's business will be smaller in value than this week's, and so on in a steady ratio. One is, therefore, obliged to leave some margin for contingencies, but the margin for contingencies may safely be smaller with a declining business than with an expanding one. Of course, if a time of pressure unexpectedly comes, one can much more easily meet it by putting extra pressure on men and machines, if one knows that it cannot last for long. As a rule, therefore, one finds that contracting businesses are working at a lower cost per unit than expanding businesses, and there is, as already shown, a quite reasonable explanation of this phenomenon; but there is, of course, another explanation possible—less reasonable, but none the less important—and that is the personal equation. Times of expansion, when those responsible for the organisation and management are worked to their utmost capacity, and when they are also earning good profits, are not the times when, having done the work that lies immediately to hand, men are going to sit up at nights thinking how

they can effect small economies; but on the other hand, in bad times, when they have not enough to occupy them fully (for they, of course, are not being reduced *pro rata* as the workers are reduced), they have time on their hands, and the vision of dwindling profits is a very active spur to the imagination in devising methods of saving money and preventing waste. That particularly applies to those in the most responsible positions, but in a sense it applies to practically all save the lowest grades. Prosperity is in a sense demoralising, and leads to extravagance; adversity, on the other hand, tends towards economy. That is one reason no doubt why, as between times of great pressure and comparatively slack times, business profits do not vary more than they do in practice. Business profits, however, must not be confused with the declared profits shown by the accounts of public companies. Every one knows that by means of different kinds of reserves—some disclosed, some hidden—practically all permanent businesses deliberately average up their disclosed profits from time to time, because they know perfectly well that they will be expected to pay more or less uniform dividends. There is really little or no connection between the published profits of a company and its true earning capacity during the same period of time. One must have a knowledge of the internal accounts before one can expect really to get at working results.

Stationary Businesses.—Stationary businesses may, of course, be dismissed with very few words from an organising point of view. They represent the ideal of simplicity—as it was yesterday, so it will be to-morrow; the same number of customers, the same quantity of

sales, purchases, and profits; no new problems to be overcome, and practically no skill in management required of any high order, merely departmental management. But passing on to temporary businesses, some new problems arise that call for consideration.

Temporary Businesses.—A "temporary" business is a term fairly applicable to any venture which in the nature of things has a limited life, such for instance as a mine, or an exhibition run for commercial purposes at a profit, or the side-show of an exhibition. The term may also be applied to any business which, although originally started as a permanent concern, has by some alteration of conditions become obsolescent. As a case in point, take the business of a horse cab proprietor. The conditions are such as to offer no reasonable inducement for further capital expenditure, or even wise expenditure on capital renewal. That being so, it is merely a matter of waiting for the end, and trying to make the most by way of profits in the meanwhile.

Possibilities of Renewal Elsewhere.—In some cases, of course, it may be quite possible that although the immediate business is of a temporary nature, there is the possibility (and the intention) of opening up a new business elsewhere when the present one comes to an end. In that way, for instance, the side-show of an exhibition might at the close of that exhibition be moved to some other suitable site. If the temporary business is the working of a ship, when that ship becomes lost, or obsolete, one may purchase another ship and work that. Businesses of that kind are in a sense capable of perpetual renewal, and they hardly come under the heading of temporary businesses at all;

but they are worth considering in passing, because they from time to time involve the discarding of a considerable amount of capital expenditure, and the incurring of other capital expenditure more or less to take its place. But for such concerns to be upon a satisfactory basis, it is clear that in those cases one must depart altogether from the usual practice of disregarding the intrinsic value of capital expenditure. When the assets from time to time have to be sold, the difference between the price they realise and the price that they originally cost is a realised loss. You may call it, if you like, a loss of capital—and probably in any event Income Tax Surveyors will insist that it is a loss of capital—but for purposes of finance one cannot pretend that one is conducting business at a profit, unless the profit is more than sufficient to cover all such losses and leave a margin over and above. In these cases one ought really to regard *all* assets as Floating Assets, and to value them accordingly in any interim Balance Sheet that may be prepared; recognising that sooner or later they will have to be sold, and that, therefore, they ought not to be brought into account in the meantime at a figure that will throw the whole of the ultimate loss on realisation into the comparatively short period of time when the realisation takes place. This is, of course, merely another instance of the business man's instinctive effort to average stated profits.

Staff Difficulties.—But with the more usual type of terminating business, one has further to consider staff difficulties—the difficulties that are naturally experienced in securing an efficient staff for only a limited period. Of course these difficulties will vary very much according to

what the period may be, and according to the class of men required. For quite subordinate positions no difficulty is likely to be experienced, however short (in reason) may be the life of the temporary business; but directly one gets into the higher positions, one must recognise that under normal circumstances one cannot pretend to offer anything in the shape of a career, and therefore, if men are required of a better class than those who are content to live from week to week, or month to month, they must be offered materially increased pay. That means that the temporary business will normally be a more difficult one to conduct economically than a permanent business; but, of course, this may be modified where various temporary businesses are under the same control, and where, therefore, although each separate business is temporary, the control that works them is permanent, and can move its employees from one place to another—thus for all practical purposes finding permanent employment for them year in and year out. Then, of course, no such difficulty arises. That, for instance, is a feature that ought to be altogether in favour of the management of seaside and provincial hotels in groups of companies, instead of each separate hotel being an independent entity. The attendance at the different hotels will doubtless not be all uniform, and it may be possible, therefore, to move managers and assistant managers about from time to time, a man competent to be manager of an hotel in the off-season being moved on to a less important one as the season advances, or possibly retained as the sub-manager, with a man more experienced for the head. In such ways there is clearly scope for large concerns to be worked more

economically than small concerns working as individual units; but it is practically impossible to lay down any general rules that are not subject to numerous exceptions.

Seasonal Fluctuations.—On this subject of expansion and contraction, some businesses are, of course, far more liable to fluctuation than others. Some businesses will fluctuate according to the season of the year. That is a kind of fluctuation that can be foreseen, and it may be possible to economise by taking on recruits in the busy time from men who are being discharged by other concerns which have their busy season at a different time of the year. In that way—as in the case of hotels, just mentioned—one may find concerns whose demands dovetail into each other, whether they are under the same control or entirely independent; but the most disturbing fluctuations, and those which cause the greatest difficulty to deal with in practice, are those arising from some unusual event that cannot be foreseen any reasonable distance ahead.

Unforeseen Fluctuations.—In this connection there is probably nothing within comparable distance with the fluctuations caused by an outbreak of war and the subsequent declaration of peace. These have an enormous effect upon the outputs of very large classes of businesses, and the effect is, of course, many-sided. It is not merely that certain classes of work—and certain kinds of services—are called for that are not normally in demand, but that the labour markets are depleted by the withdrawal of reservists. The number of workers is reduced at the time when the quantity of work is perhaps greatest, so there is the dislocation both ways. It is, of course,

impossible in such emergencies as that to avoid a considerable increase in the cost of production. These increases in the cost of production doubtless primarily account for general increases in prices, but there is considerable scope for intelligent organisation in keeping those necessary increases of cost within somewhat narrower limits than one's competitors. In that way one may get the advantage of a high selling price which their want of foresight makes the ruling price, and by being able to work at a lower cost one may be able to make a much larger ratio of profits than those who give much less skilled attention to these details of organisation. At such times these important matters are very generally neglected, partly because many have not the time to think them out during periods of rush; partly because they are problems which, if not thought out in advance, cannot be dealt with effectively in an emergency, when there is naturally little time for serious reflection.

CHAPTER XVII

THE RELATIONS OF SPECULATION TO BUSINESS—INSURANCE

Business and Speculation.—In discussing the relation of speculation to business it is perhaps as well to devote a little time in the first instance to definitions. A "business man" is usually regarded as one who steadily and persistently applies himself to the work that lies before him—not by any means necessarily without intelligence, but still persistence seems to be largely the root idea. To take an analogy from natural history, one almost inevitably associates the bee with the idea of business; and that is not perhaps such a wide shot after all, because the root of the word "business" is undoubtedly the hum of the bee's hive, and that really seems to give a very fair idea of "business" for our present purposes. "Speculation," on the other hand, is an occupation which consists largely of "looking around" for opportunities of doing something to one's advantage. It is, therefore, not necessarily a continuous occupation, save that if one is going to take advantage of opportunities as they arise one must be insistently on the look-out—much in the same way that a cat has to watch perhaps for hours at the mouse's hole in order to make sure that she is on the spot when the mouse comes out.

Good Business involves Speculation.—As a matter of fact, that is really the keynote of the whole matter. In real life it is rarely possible altogether to dissociate "business" and "speculation." That applies not merely in connection with commercial and financial matters, but really with the whole of life. The most humdrum business will, now and again, give rise to opportunities which the business man must be equal to taking advantage of, if he wishes to make the most of his chances; on the other hand, the man who has no settled occupation, but seeks to make a living out of "picking up" things (which is perhaps the root idea of speculation), is almost certain not to keep his attention sufficiently closely glued upon what is going on as to be able to take advantage of every opportunity as it occurs. The qualifications necessary for "business" may be rather different to those required for successful "speculation," but a combination of both is that which is likely to produce the most satisfactory results. But that, of course, is assuming that speculation is limited to that which legitimately arises out of one's business. It does not do to allow one's attention to stray, looking for opportunities entirely outside, arising out of matters concerning which perhaps one knows little or nothing. Such catholicity would necessarily distract one's attention, and take up time that ought to be employed at one's own particular occupation.

But not Gambling.—Speculation outside one's own particular line of business is for all essential purposes gambling; and that, indeed, seems to be the real distinction between the two. The gambler is the irresponsible person who, instead of working, plays about. In a book such as this it is perhaps hardly necessary to point out

in detail the disturbing effects on legitimate business and legitimate speculation caused by the irresponsible meddling of outside gamblers. These dabblers, coming in from outside, are a very real disturbance to business. By creating a purely fictitious demand, or putting forward what purports to be a supply that has no real existence, their operations necessarily affect business prices; but, apart from that, inasmuch as they are in the great majority of instances dealing with matters concerning which they know little or nothing, and usually are hopelessly overtrading at that, the result sooner or later is almost invariably the same—that they lose money, and (because they are overtrading) are eventually unable to meet their obligations. Gambling, therefore, is a very fruitful cause of insolvency, apart from the disturbing effect it has on market prices.

Legitimate Speculation.—But opportunities for speculation arise in a perfectly legitimate way in connection with almost every conceivable business, largely because markets are continually fluctuating. The fact that market prices are fluctuating—that supplies are fluctuating—makes it perfectly reasonable that those who have legitimate claims to deal in those markets should endeavour to acquire a sufficient knowledge as to the more usual causes of fluctuation to enable them to take advantage of these fluctuations, instead of experiencing them invariably as something inconvenient or detrimental. The man who knows that in the course of a stated period he will have to buy a certain quantity of any commodity, and who knows further that the price of that commodity will vary during this period, may very profitably devote his attention to the consideration of these fluctuations,

with a view, as far as possible, to buying at the lowest price ruling during that period, instead of buying at the average price, which is the most that he could hope for—even with reasonable luck—if he paid no special attention to the matter. The man who operates only from day to day can never expect to buy much better than at the average market prices over a lengthy period. The man who thinks ahead may hope to buy—and with knowledge and experience will in the majority of cases succeed in buying—at less than the average price; and the saving thus effected will, in the majority of instances, be a very ample recompense for the time and trouble spent in acquiring the necessary knowledge and experience. But the acquisition of this knowledge and experience is not merely a matter of making increased profits; it is also the best possible means of safeguarding against having to pay *more* than the average price—a position of affairs that might very easily arise if one were to work absolutely from hand to mouth. Speculation therefore (at all events legitimate speculation) is largely a method of insuring against preventable waste—and the term is used here, not in the sense in which it is used in the insurance world, but in the perhaps more effective sense of really guarding against a contingency and thus saving a preventable loss, instead of making arrangements to enable one to secure some form of compensation in the event of an undesirable contingency occurring.

Insurance and Insurable Interests.—But in every business there will always be contingencies that no amount of experience—no amount of technical or intellectual knowledge, or foresight—can altogether avoid, and with regard to these what is ordinarily called

"insurance" is undoubtedly the best means of guarding against the possibility of a variety of different classes of losses. But this form of insurance—the effecting of a policy of insurance—can, of course, in itself be a means of pure gambling. If any one who has no insurable interest in the subject matter of the insurance takes out a policy, that for all practical purposes becomes a bet. For example, to insure, say, that one shall receive a stated monetary compensation in the event of one's business premises and goods being damaged by fire is perfectly legitimate, because one is directly and financially interested in the catastrophe protected against by the policy; but if one were to seek to effect a similar insurance upon somebody else's goods and premises, that (usually) would simply amount to a bet with the insurers as to whether that person's premises and goods would catch fire or not within a stated time. At most one could only be in a position to have an indirect insurable interest in the matter. If this person were a competitor, one might be affected by the dislocation of his business that would result from the total or partial destruction of his business premises; but in that case one would presumably gain, and not lose, by the calamity. But, on the other hand, if one were relying upon this individual to supply certain goods that one required by a certain date, then one might have a legitimate interest in insuring against the happening of any event that would make it impossible for him to carry out his contract. Such an insurance would then be quite legitimate, as one would have a *bonâ fide* insurable interest in the contingency; but that would not be a very business-like way of safeguarding against this possible loss, because fire would be only

one of a large number of causes that might interfere with his execution of the order, and if we are going to insure at all it would be far better to insure against all contingencies likely to cause a breach of the contract for the supply of goods by a stated time.

Different Classes of Insurance.—It will perhaps be convenient here to enumerate briefly the more important classes of insurance. The majority of these are perhaps very well known, at least by name; but there are a few contingencies against which insurance may sometimes be effected with advantage much more frequently than is usual, and there are also developments of some of the more well known which are worth consideration.

Marine Insurance.—Probably the earliest form of insurance is insurance against loss through the risks of the sea—marine insurance, as it is called. That covers practically every kind of risk during the voyage. It is by no means necessarily limited to fire, or even to fire and tempest. Practically all commodities forwarded from one country to another by sea are protected by policies of insurance, and the effect of that in the long run, in the case of a large business, is, of course, to spread what may be called the normal amount of loss arising through these catastrophes, so that an average amount is charged against the profits of each year.

Internal Insurance Funds.—Very large concerns—such as the P. & O. Steamship Company—may quite prudently effect their own insurance, as they call it, by setting aside a stated sum each year out of earnings, and only having recourse to the fund thus set aside to make good losses arising from time to time through the happening of those events that are normally covered by insurance policies;

but it is only a very few of the largest concerns that would have a sufficiently wide experience to produce a reasonable average of risks within a reasonably limited time. For any small concern to endeavour to effect its own insurance in this way would no doubt be one of the rankest forms of speculation possible, even if it were not mere irresponsible gambling; for an insurance fund which is not large enough to be capable of meeting any claim that may reasonably be expected to be made upon it is clearly no insurance fund at all, but a mere delusion. Smaller concerns, therefore, have either to band together on the co-operative principle (and in marine insurance that is quite a common plan for certain classes of risks), or they have to do what all business men do when it is not worth while to do the work themselves—*i.e.* employ some one else to do it for them, either in the nature of an insurance company, or that association commonly known as "Lloyd's," which for all practical purposes may be regarded as an exchange where individual insurers, or underwriters, meet together to consider (and, if approved, accept) such proposals of insurance as may be offered to them. These individual insurers, even if they conduct a very large business, rarely put more than £200 into any one risk; that is to say, they rarely accept a liability which on the happening of the worst event will cost them more than £200. Even a moderate insurance, therefore, has to be undertaken by a number of underwriters. Each underwriter will accept many thousands of risks in the year, and thus to a certain extent he may (by thus limiting the amount put against any one risk) hope to get a fairly uniform experience from year to year; but, of course, directly he departs from this rule

of a number of small ventures, and seeks to take relatively large lines, he is for all practical purposes betting with the party who has effected policies with him. It is no longer legitimate business, but the rankest kind of speculation, and the results of that speculation must necessarily be extremely unequal from year to year. Until quite recently Lloyd's insurance has been conducted upon a somewhat haphazard principle, which probably in any other country would not have produced such all-round satisfactory results as it has produced here; but the Committee of Lloyd's has recently recommended that its members should have their individual accounts audited by accountants approved by the Committee, and to keep these accounts so that the premiums received by each underwriter, instead of going straight into his pocket, should go into a definite Insurance Fund, and remain there as a Fund to meet claims, withdrawals for the personal use of the individuals being only made on the certificate of the Auditor that the Fund remaining is adequate, having regard to the outstanding risks. Until this recommendation came into operation, the only safeguards that the public had were the inquiries made by the Committee before admitting members, and the cash deposit the latter were required to put up as a guarantee to meet all claims made upon them. Matters are certainly placed upon a more business-like basis now, and although the recommendation is not compulsory, practically all the members of Lloyd's have already conformed to it. The insurance of an isolated transaction is for all practical purposes indistinguishable from a bet that a stated event will, or will not, happen within a prescribed time; but with a sufficiently large number of similar transactions,

the average experience will not vary very greatly from year to year. Under these circumstances insurance may become one of the soundest and most stable classes of business conceivable.

Insurance Companies.—In addition to Lloyd's, there are, of course, registered companies, and companies incorporated by Act of Parliament, transacting insurance business of all kinds. The majority of these work together, to the extent that they adopt a uniform tariff for the more usual classes of insurance business, and these are called "tariff offices"; but business men often complain that the tariff rates are in some cases unreasonably high, and this dissatisfaction with the tariff rates gives encouragement from time to time to the formation of new companies not bound by any such rates, which are able to accept business upon any terms that in their opinion are commensurate with the risks involved in each separate case. But the history of non-tariff offices is practically the history of their gradual absorption by tariff offices. Few of them remain outside the tariff, save during the first few years of their existence. It would seem, therefore, that, in the long run, the tariff rates are found to be so fair that there are no great prospects of a large and successful business being built up upon lower and competitive rates.

Fire Insurance.—A class of insurance that is practically universal is insurance against loss by fire. All fire insurance is a contract to indemnify the assured against any loss arising from the destruction of specified assets up to a stated aggregate amount; and if, as is usually the case, there is what is called an average clause in the policy, then if the total amount covered by the policy—on

which, of course, the premium is based—be less than the ascertained value of the total assets that policy is supposed to cover, then it is assumed that the assured is himself taking the risk in respect of the deficiency, and must therefore himself contribute *pro rata* towards the loss. Thus, to put the matter quite shortly, if a man endeavours to save insurance premiums by only insuring his goods for half their value, then, in the event of even a portion of his goods being destroyed by fire, he will only be able to recover half the value of the goods so destroyed. That, of course, is perfectly reasonable, because the premium is based upon the assumption that all the goods are brought into account that are subject to the same risk. It would be quite unfair for the assured to pretend that the half of the goods which he himself insured was the half that remained undestroyed. No one can afford to give an option for nothing.

Insurance of Rent.—Arising out of fire insurance come two further classes of insurance against consequential loss. The first is against loss arising through the delay in rebuilding premises that have been damaged or destroyed. If a building destroyed by fire takes twelve months to rebuild, not merely is the cost of rebuilding lost, but also the twelve months' rent. If the assured are occupiers only, they will have to pay rent to the landlord although the premises are unoccupied. If they are freeholders and occupiers, they lose the income which in that case is the benefit to be derived from the use of the premises. They are put to the loss of having to find, and pay for, temporary premises elsewhere. Therefore it is very usual in these days for insurance companies to grant

policies covering a loss in the way of rent; but usually these policies are limited to an amount representing twelve months' rent on the premises, which of course in the great majority of cases is sufficient, but with very large and important buildings might be quite inadequate.

Profits Insurance.—But, even supposing the assured are paid in cash the money value of the goods destroyed, a sum sufficient to enable them to rebuild their premises and a sum sufficient to enable them to rent temporary premises in the meanwhile, there is still that indefinable loss represented by the diverting of attention from one's own business to other matters. There is the inconvenience that they are necessarily putting their customers to by a compulsory change of address: there is the fact that possibly the temporary premises may not be equally suited to their purpose: there is the certainty that it will be at least some little time before these temporary premises are in fair working order. Every fire of more than quite trifling dimensions is bound not merely to produce material losses, but also a loss of profit that might reasonably have been expected to be made had the fire not occurred. Of recent years a quite limited number of insurance companies have been willing to effect insurance against loss of profit of this kind, and such an insurance seems to be a very wise and business-like precaution, particularly, of course, in connection with those concerns most likely to suffer loss by a temporary displacement. It is difficult to conceive any kind of business that would not suffer some loss, but losses would be far greater in some cases than in others. If one has a very special kind of plant, for instance, that cannot be replaced at short notice, the loss must be

very serious, because in the meantime the output will be entirely stopped. Again, a retail trade, which deals direct with the general public, is bound to lose by a change of address, particularly if suitable temporary premises cannot be found quite close to the original address.

Boiler Insurance.—Coming largely under the same heading as fire insurance are boiler insurance and burglary insurance. Boiler insurance may, from one point of view perhaps, be regarded largely as an insurance against loss through carelessness, for certainly with proper supervision boilers ought not to explode; but in very exceptional cases accidents of that kind may occur that can hardly be attributed to negligence, and in so far as that is the case they are obviously fit matter for insurance, because, the risk being remote, the cost of insurance is small.

Preventive Effect of Insurance.—But, apart from that, boiler insurance is a valuable precaution because it means that, upon payment of a very trifling premium, one gets —one may say for all practical purposes without payment —the services of experts who come and test one's boilers from time to time and satisfy themselves, as far as science will enable them to do so, that everything is in a thoroughly efficient working state. If one owned thousands of boilers, it might be worth while to have one's own inspectors. If one only owns one or two, it would clearly not be worth while; and if one were to hire inspectors, the cost would be at least as much as the cost of an insurance policy, and naturally less satisfactory in the long run. So that here the effect of insurance is to minimise the risk of loss; not merely to compensate

if the undesirable happens, but also to operate in the nature of a preventive. Going back for a moment, in practice fire insurance very often has much the same tendency, because the premiums charged for fire insurance are to some extent regulated by the presence, or absence, of suitable fire alarms and extinguishing apparatus. One may even find it difficult, or impossible, to effect an insurance in the absence of all possible precautions; so that here incidentally the insurance companies, in a sense automatically, tend to keep business men up to a high state of efficiency in matters concerning which they are Past Masters, and that clearly is all to the good.

Burglary Insurance.—Burglary insurance is only connected with fire insurance in the sense that frequently combined policies are issued to cover the two risks. Whether the mere fact that a man is insured against burglary is likely to minimise the risk of losses occurring is perhaps a much more open question than with regard to boiler explosions or fire. The tendency at first sight would appear to be rather to make one omit precautions that otherwise one would adopt; but here again, of course, the insurance company is looking after the assured, and insisting upon reasonable precautions as a condition of undertaking the business, so that it is very doubtful whether one can reasonably say that the tendency of the growing practice of insuring against burglary is to make people more careless in looking after their own belongings. So far as business houses are concerned, it seems more likely to have the tendency of requiring them to take more effective precautions as far as possible.

CHAPTER XVIII

THE RELATIONS OF SPECULATION TO BUSINESS —INSURANCE (continued)

Accident Insurance.—The next class of insurance to which attention may usefully be directed is insurance against accident. This may be divided into two classes: insurance against accident to employees for which the employer is liable under the law of the land, and insurance against loss to a business arising from the disablement of some guiding spirit. With regard to the insurance of employees, the risk of loss arising under this heading in the case of a large business may be a very serious item, and the tendency seems to be for liabilities of this kind to be increased rather than reduced. In the case of concerns with only a dozen or a score of employees, the risk of an accident which might easily involve a loss of a thousand pounds or more is of course ever-present; but of course it is not at all likely to occur in the course of the ordinary lifetime of one business. Clearly, therefore, it would be highly speculative to run such a risk without insurance. But if employees number hundreds, or even thousands, then the probability is that in almost every year there will be some claims; and although the claims against each

separate year will not be anything approaching equal in amount, the claims for any period of ten years probably would not differ very extensively. An arrangement, therefore, by which a certain amount is set aside as a reserve to meet such claims when they arise, would seem to be all that prudence makes necessary in this direction. In very large concerns, such as railway companies, it would obviously be fantastic to insure against loss, as representing the compensation that they might be called upon to pay to the public in case of accident—at all events in the case of the larger lines. In the case of a very short line, or in the case of a provincial omnibus or tramway company, on the other hand, these would seem to be very suitable subjects for insurance.

With regard to the risk of loss arising through the disablement of some guiding spirit who cannot be spared from the helm, if a business really is in the position that the temporary disablement of any individual will cause serious loss, that would seem to be a very suitable subject for insurance, for the expense would be altogether trifling compared with the advantage of being compensated against a loss of that kind should it arise; but, on the other hand, it is as well to bear in mind that, with a proper system of organisation, one ought always to aim as far as possible at not being dependent upon any one individual. Even those occupying the higher positions ought not to be indispensable—or at all events not to be indispensable for a limited time—so that the necessity for insuring against this contingency is one that should not arise; but where the necessity exists, there can be little doubt as to the expediency of incurring the trifling expense that would be involved in insuring against it.

The difficulty in practice would probably be that one would not be able to insure against such a contingency for a sufficiently large sum to make it worth while.

Breach of Contract.—The next class of insurance to be considered is against loss through some form of breach of contract. It is possible, at all events in approved cases, to effect an insurance against loss arising through a breach of contract on the part of some third party. In certain cases, such insurances may be very desirable and very prudent; but clearly they must be exceptional cases, for if one were to attempt to insure against loss through breach of every contract in which one was interested, the expense would be absolutely prohibitive. But if, upon an occasion, one has entered into a contract of unusual magnitude, and is therefore very specially interested in that contract being duly carried out, it is conceivable that it might be worth while to incur the expense of insurance. For instance, if one were building a new works, any serious delay in the completion of the building would of course involve very considerable losses: it may well be worth while therefore to insure against loss arising through such delay. Of course the building contract may stipulate that some responsible guarantee shall be found by the contractor for its due performance. That, as a matter of fact, is the usual arrangement; but naturally the cost of the guarantee is almost inevitably added to the contract price, so that the party benefiting by the insurance is almost certain to be the one that ultimately bears the expense. In exceptional cases such insurances may be worth while, but certainly not as a general rule.

Bad Debts Insurance.—In these days of the development of insurance against almost every possible contingency, it is possible to effect insurances with a few companies against loss arising through bad debts; but whether it is worth while to incur the expense is, again, a very open question. With some particularly large amount due from some particular customer it might be worth while, but certainly not as a general rule. But it is impossible to insure against loss from bad debts for anything approaching the full amount in question; the most that can be done is to insure up to about 40 or 50 per cent. of the claim, and the creditor is regarded as being himself the insurer for the balance of the amount, so that whatever loss is sustained, part at least of that loss must fall upon the creditor. If insurance companies did not make such stipulations, it is fairly evident that in the long run they would be bound to lose money on business of this description: there would be little inducement left for traders and others to exercise reasonable care before giving credit, if they could fully insure themselves against all possible loss by way of bad debts. For practical purposes, insurance against bad debts seems only of use in ordinary business as a branch of insurance against breach of contract—as something to be used sparingly, and in very special cases, to avoid a loss beyond one's usual limit. Of course those are the cases in which it would be found most difficult to effect the insurance, and most expensive.

Insurance of Life of Debtor.—Another kind of insurance indirectly intended to avoid loss by way of bad debts in exceptional cases is to insure the life of a debtor. One may be quite satisfied as to a debtor's ability to pay if he

is granted time; but, should he die before that time expires, it may be equally clear that some loss will accrue. There is no more difficulty in effecting an insurance on the life of a debtor than on the life of any other person equally sound from a medical point of view, and therefore in somewhat exceptional cases life insurance of that kind may be a very prudent investment. Of course it is incidentally an investment, as well as an insurance against this particular risk. If the debtor dies before he has had an opportunity of paying back his debt, the creditor is certain to make a profit on his insurance, for the premiums paid will in that event be very much less than the amount receivable on the policy. If, on the other hand, the debtor lives, he is presumably then able to pay off the debt by some instalments that have been arranged, and the contingency the creditor had chiefly in mind has not arisen; but the life policy remains as an investment, and although perhaps it is not the investment one would have chosen in itself, it certainly does not represent the dead loss that most insurance premiums do when the contingency contemplated does not arise.

Insurance of Life of Manager.—A further extension of this idea of insuring the lives of individuals against their early death very often arises in connection with private companies, and other comparatively small companies dependent very largely for their success on the management of individuals. If a company has acquired a small business (and therefore one in which the personal element cannot possibly be altogether excluded) upon condition that the vendor shall remain as managing director (say) for the next ten years, and the managing

director dies (say) within the first two years, there are very considerable risks that the company will find that the goodwill has seriously depreciated, and that it has made a loss by purchasing the business. A contingency of that kind is one that it may be well worth to provide against by insurance; and if, owing to the age of the person whose life has to be insured, the premiums become prohibitive, one may still serve one's purpose by insuring against his death within a stated period. An insurance of that kind would be very much cheaper than the insurance of a sum payable upon death, whenever death may happen; and one may still further limit the cost by arranging that the sum to be paid in the event of death is to be on a sliding scale. Thus on a policy of insurance for £10,000, one might arrange (say) for the policy to be one for £10,000 if death occur in the course of the first two years, for £8,000 if death occur in the second two years, and so on. In that way the cost of insurance is reduced to a minimum, and roughly approximates to what one might expect actually to lose—for presumably the longer death is postponed the less will be the loss suffered, as in the meantime there will have been ample opportunity of building up an efficient organisation and training other managers.

Insurance of the Lives of Partners.—Another class of insurance not at all suited to very large businesses, but very useful in connection with comparatively small ones is on the lives of partners, so that in the event of one partner dying—a contingency which will involve his representatives being paid out the amount due to his estate—the burden thrown upon the surviving partners

may be lightened by their receiving payment under a policy of insurance. There are various ways in which partnership insurance may be effected, but the most usual one in the case of two partners is for a stated sum to be paid on the death of whichever dies first, and similar arrangements can of course be made with three or more partners; but if such insurances be effected, and if the arrangement between the partners be that the benefit of the policy is to go to the survivors, to enable them to become possessed of the necessary monies to pay out the representatives of the deceased partner, it is important to bear in mind that it will probably be quite inequitable to charge the insurance premiums as a business expense. The reason for that is that under normal circumstances the partners will not be all of an equal age, and in the majority of cases the elder partners will be entitled to a larger share of profits than the younger partners. Now supposing there are two partners, respectively aged (say) 30 and 50, and that the elder is entitled to two-thirds of the profits and the younger to one-third, it is clear that the advantage of insurance is in favour of the younger partner, for two reasons: first, the risk of the elder partner dying first is considerably greater than the risk of the younger partner dying first; and secondly, if there were no insurance and the elder partner died first, the financial embarrassment of the younger partner would be considerably greater than that of the elder partner would have been, had he survived, because the surviving elder partner, only having to pay a comparatively small amount by way of goodwill, and being (presumably) possessed of the larger capital, would be able to stand

the strain much better. Clearly therefore, in general, the younger partner enjoys larger benefits out of the insurance than the elder partner; consequently it would be quite inequitable to apportion the cost of the insurance between the two so that the elder had to pay two-thirds and the younger one-third of the premium. Roughly speaking, the apportionment ought to be in the inverse ratio to profits; but of course, when arriving at an actual apportionment, one would have to consider the relative ages of the partners, which are the factors governing the amount of the premium. A joint life insurance is practically two insurances combined, and there would be no difficulty in getting the insurance company to quote the apportionment, and in charging up each portion accordingly as an expense to be borne by the other partner directly, and not by the business.

Fidelity Insurance.—The next class of insurance is one well known and widely resorted to, and that is insurance against loss through the dishonesty of employees and agents—"fidelity guarantees," as they are called. Here again, in the case of a very large staff, one might think it was hardly worth while to incur the considerable expense that would be involved, for the expense of the insurance depends chiefly upon the number of employees; but an insurance of this kind has indirect advantages in the same way that fire or boiler insurance keeps one up to the mark, in that it is necessary to have an efficient system of supervision and check. It would be very difficult to effect an insurance of this kind in the absense of a professional audit. And there is yet another indirect advantage of this insurance, particularly in the case of small business houses—that

the insurance company invariably prosecutes defaulters, which undoubtedly acts as a deterrent. Employers, if they do not insure, as likely as not would not take the trouble to prosecute, unless they thought it absolutely necessary for their self-defence in the future. There would at all events be a very fair chance that a defaulter, when discovered, would be allowed to go scot-free. If he knows that there is a fidelity guarantee policy in existence, he also knows—or is in a position to know—that, should he be discovered committing any fraud, prosecution is absolutely certain to follow ; and that is a very powerful deterrent. Fidelity Guarantee is certainly one of those classes of insurance that have the effect of reducing the aggregate amount of loss to the community, whereas in many cases the tendency is rather to increase loss by encouraging carelessness.

Plate-Glass Insurance, etc.—For instance, take the case of plate-glass insurance. There can be little doubt that if a man has effected an insurance against loss through the breakage of plate-glass, he is no longer interested in the matter, beyond that he may have to suffer a certain amount of inconvenience, during the time that elapses between the breakage and the repair of the damage ; but there is certainly more encouragement to carelessness, particularly on the part of employees. Similarly with regard to insurance against driving accidents, if the owner of a number of carts, or motor-cars—running all sorts of risks of third parties claiming for losses arising through carelessness of employees, and what not—arranges for all these risks to be covered by insurance, he is not so interested in securing steady drivers as he would be if the loss were bound to come upon him

personally; and so far as the driver is concerned, there can be little doubt that insurance is decidedly demoralising. If the only possible risk that a driver can incur is the risk of injury to himself, or of a possible conviction for manslaughter, there is much less inducement to be careful, and more temptation to take risks, than if he is actually responsible for any damage that he may do to third parties. From the point of view, therefore, of the insurer there can be little doubt that insurance of this kind is much more speculative than the classes of insurance where the mere existence of the insurance has a preventive tendency, and it is more or less of an open secret at the present time that insurance companies are not making any profits out of their motor-car policies.

Contingency Insurance.—Turning now to general classes of insurance against undesirable contingencies generally—such as trade depression, the breaking out of war, and so on. Almost every business is liable to considerable fluctuations in profit-earning from some cause, or causes, entirely beyond its control, but nevertheless quite capable of enumeration. Thus, for instance, the profits of a railway company will (among other things) fluctuate according to the weather, to the general trade of the country, the price of coal—and of course the rates of wages ruling, which are a very important factor. Now all these tendencies can be insured against. Whether they can be insured against at remunerative rates by a railway company is another story altogether; but in many businesses what may be regarded as the chief dangers are dangers that are not very likely to happen—or are even very unlikely to happen, but are still within the possibility of practical experience. The

more unlikely they are to occur, the more suitable are they for insurance ; because the more improbable they are, the cheaper will be the cost of the insurance. Thus a concern carrying on a large foreign trade with some particular country, or group of countries, might well find it worth while to keep a running insurance in force against war with those countries, or against those countries being embroiled in war with any other countries.

Speculation as a Mode of Insurance.—A concern dependent for its prosperity upon one or two raw materials at reasonable prices may consider it worth while to take steps to cover exceptional losses arising through those commodities going to very high prices. It is doubtful whether it would be expedient, in the ordinary course, to cover this particular class of risk by insurance in the ordinary sense, but the same practical result can be attained in a variety of other ways. One can imagine, for instance, a concern dependent very largely upon copper as a raw material : it has to make its contracts ahead, and therefore, if the price of copper goes up to any serious extent, it may find the profits on its contracts very seriously affected ; on the other hand, if the price of copper goes down, it will reap additional profits. Now quite a simple way of insuring against loss of profit through a rise in any specified raw material is by dealing "in futures" in that particular class of commodity. If one has no insurable interest—no existing contracts—the dealing in futures would be pure gambling ; but if one has contracts which—to be profitable—necessitate the price remaining low, it may be nothing but the most prudent business course to "bull"

that particular commodity. Then, if the price goes up, the benefit of these operations in futures will compensate for the resulting loss in the execution of the contracts. For all practical purposes, of course, these dealings in futures are no more speculation than any other kind of business contract entered into for performance at some future date. It is merely a question of buying ahead, because in the future one will require a specified commodity. If the price is right now—if we know that we can make a profit at the present price—then we close with the present price, instead of speculating whether the price will go up or down later on. Whenever a man contracts to supply any article which he is not possessed of at the time, he is entering into a speculation as to the possible rise or fall in the market value of that commodity between the date of the contract and the date of delivery; but if, as he settles his contracts, a man buys to cover the materials he requires, instead of it being a speculative transaction, it is the very reverse, in that—as far as possible—it eliminates the element of uncertainty from ordinary business transactions.

Bear Operations as Insurance.—Sometimes it may not be altogether convenient to perform these operations in precisely the same commodity as that which is really at stake. As a rule it is practicable; but sometimes there may be some slight difficulty in the way. Then it is equally legitimate to select some other class of commodity —or some other class of stocks or shares, which will without doubt serve the purpose equally well. For instance, a merchant interested in foreign exchanges may cover himself against risk of loss on exchange by buying

trade bills ahead of his immediate requirements; but if that is not convenient, or not practicable, he can easily effect precisely the same result by buying or selling the Stock of the foreign Government concerned, which will be affected by fluctuations in exchange. Such an operation is, however, not quite so satisfactory; in the sense that it is not so entirely safe, because the Stock of the foreign Government will be liable to fluctuations through other causes besides exchange. Probably the only really safe "hedge" of that kind is in the case of a man who has various operations on foot which are perhaps not quite brought to the stage of being completed contracts, which may "go off" if something untoward occurs—say of a political, or financial, nature. Supposing, for instance, a man is very anxious to sell his business to a limited company. He may have everything arranged up to a point, but has not got exactly to the stage when he can get his capital underwritten. He is therefore still open to the risk that, if there should be a bank crisis in New York, or trouble in the Balkans, or if the King should die, or if a thousand and one things should happen which cannot possibly be foreseen, the deal will at all events have to be postponed, because it will then be impossible to get his capital underwritten upon satisfactory terms. Such a man may compensate himself against loss by selling Consols which he has not got—by "going a bear" on Consols. If any of these unforeseen and undesired things were to happen—he may argue—the result would inevitably be that Consols would fall. If that would not be the inevitable result, then of course Consols is a bad selection; but, assuming the selection be good, if the undesirable happens, he

makes a profit on his bear which to some extent compensates him for his loss in other directions. If, on the other hand, the undesirable events do not happen, it is possible that Consols may rise, although it does not necessarily follow that they will ; but the worst that can happen will be a certain amount of loss on the bear operations, which will be very much more than covered by the profit he will be able to make on carrying his deal through. It is not quite a question of level chances. The Stock selected for the bear operation is one which (presumably) will remain fairly stationary under normal conditions, so that under normal events there is no serious risk of loss ; and the loss, whatever it may be, is a sum which the operator is quite content to pay out of his profits on the deal. But if anything happens to prevent the deal going through, and the operator's calculations have been right, then there is a profit on the bear ; and it is not a small profit, but a large profit, because there will have been a substantial fall. The fall, if things go wrong, will be considerably greater when there is little chance of it, the risk being if things go well ; so that the possibilities of a profit arising from the bear are considerably greater (as regards amount) than the possibilities of loss, but the probabilities (as regards there being a profit or a loss) are that there will be a small loss on the bear operations. It is a loss cheerfully sustained, to insure against a much greater loss arising from business being indefinitely postponed through the happening of some untoward event.

Transactions of this kind, assuming they are undertaken with sufficient knowledge to enable a wise selection to be made—assuming a man knows what is the proper

thing to bear upon—are not speculations, because we have here the existence of the insurable interest. The operator is insuring against loss on the happening of an unforeseen event. He has satisfied himself that, if that event occurs, the effect must be that the commodity he decides to sell will fall in value; and if his impressions are justified by facts, the arrangement is just as safe a means of effecting an insurance against loss as any other that can be conceived, and far more satisfactory than any literal insurance that he could effect at any reasonable premium.

Extent to which Insurance is desirable.—From what has already been said it will be seen that, speaking generally, it is practicable in these days for a person to insure against every conceivable contingency; but at the same time if one were to insure against every conceivable contingency, it is pretty certain that there would be no profit left. The premium charged on an insurance is really built up in this way: First of all, it consists of a fair price for the risk, having regard to the probabilities of the event happening. It is calculated that there will be, say, one claim per annum in respect of every thousand (or whatever it may be), and what is called the "pure" premium would thus be a one-thousandth part. Added to that must be the expenses of the insurer—the due proportion of the expenses he actually has to incur in carrying on his business—whether it be a large insurance company, or an underwriter at Lloyd's. And, added on to that again, must be a further margin representing the profit that the insurer may hope to derive from carrying on his business. There are thus three items to be added together: the pure premium, the loading for expenses,

and the loading for profit; but, as a deduction from these, the assured may in some cases receive an allowance for interest on the accumulated premiums in hand. In the nature of things, all insurance business is based upon the assumption that appreciably large sums will be received by way of premiums, that they will be invested in remunerative securities, and that expenses and withdrawals by way of profits and claims will be paid out of the accumulations; but there will always be accumulations in hand producing something by way of interest. The assured may therefore reasonably expect some deduction under that heading, which may or may not compensate for the loading for expenses. In the case of mutual insurances, the loading for profit will be omitted theoretically; but practically it will not be altogether omitted, because mutual offices do not try to trade at no profit whatever. What they aim at, rather, is to divide the profit among policy-holders when earned—and that, of course, is a matter for the future. But, however that may be, if, to effect an insurance, one has to pay not merely the pure premium—the actual value of the risk—but also some further loading, as one inevitably does under all circumstances, it is clear that when one effects insurances against undesirable contingencies, one must take the cost into account in fixing the prices on which one bases one's own profits. All risks are taken into account, and prices are loaded accordingly; so that if the trader runs the risks himself he will get the full profit; but if he wants to split his business up into a number of water-tight compartments, and hand each of these over to some one else, paying them a premium as compensation, he will in that case probably have to hand over something

in excess of the amount that he has actually been able to load his own profits with in respect of that particular risk. By the time he has insured against every conceivable contingency, and got his business down to an absolutely dead limit of perfect safety, he may be quite certain that it will be carried on at a loss; so that there is no stage under which a profitable business is devoid of every conceivable risk.

Speculation an Essential Part of all Business.—Thus speculation and business are inseparable. A business-man must be content to run some risks in all cases; and, that being so, the only point left for consideration is, what risks it is prudent and desirable to run, and what risks it is prudent and desirable to insure against? That brings us down actually to very much the same category as when we ask ourselves whether we shall make any particular commodity ourselves, or buy it ready-made; or whether we shall purchase certain services outside, or increase our staff so as to do the work ourselves? It is very largely a question of whether there is a sufficient quantity of that kind of work to do to make it worth while to specialise in the matter, and whether one has sufficient capital at command to enable one to do so. In insurance risks the capital factor will probably be the preponderating one. Given ample capital, it would probably be waste of money to insure against anything. Few business houses have unlimited capital, and in the majority of cases, therefore, some few risks worth insuring against; but the smaller the business owned, the greater the number of risks that it may be worth while to insure against. At the same time one must beware of being over-cautious, because if a man is over-cautious, one is

almost certain to find he has been very extravagant—in the sense that he has paid away in insurance premiums a sum equal to (or in excess of) the profit that he might otherwise very easily have made for himself without any really unreasonable risk.

CHAPTER XIX

PUBLIC REGULATION AND CONTROL OF BUSINESS AFFAIRS

Introductory.—In this country the public regulation and control of business enterprise—or, as it is very commonly called, "interference" on the part of public authorities—does not appear to be very popular. Public opinion seems to be distinctly adverse to anything in the nature of undue interference, and inclined to regard any form of regulation more or less with suspicion; but for all that, a certain amount of public regulation exists, at all events in connection with certain selected enterprises, and upon the whole the tendency seems to be rather in favour of increasing this regulation, either directly or indirectly. If we inquire in whose interests some public authority may be deputed to regulate business enterprise, and if necessary to interfere with or hamper it, it will be found that there are three possible points of view—the interest of the customer; the interest of the community at large; and the interest of those who have money at stake, either as investors or creditors.

The Interests of the User, or Consumer.—From the point of view of the consumer it is fairly clear that a good case for regulation can usually be made out in connection with

any concern which, either absolutely or in effect, owns some kind of monopoly. When special privileges are granted to one business concern that are not granted to all comers, and when accordingly free competition—which usually automatically brings about fair prices—is no longer available, it may be very desirable that there should be some public regulation with a view to guarding against abuse. Accordingly such concerns as railway companies, gas companies, water companies, electric lighting companies, and the like, are (in this country) not allowed to charge whatever they may think fit for their services, but are limited to maximum charges for different kinds of services; and there can be little doubt that upon the whole these arrangements work well. They appear to have been worked out most carefully, and upon the most scientific lines, in the case of gas companies. The normal arrangement there is to fix a standard price for gas, coupled with a standard rate of dividend to shareholders; whatever profits may be earned, nothing more than the standard dividend can be paid, unless some share of the surplus profits is conceded to the consumer in the form of a rebate in the price of gas. A sliding scale is therefore provided, so that as the company reduces the price of gas to the consumer, it is allowed to increase its dividends to the shareholder. With a carefully arranged sliding scale it is thus possible to apportion the benefits derived from increased efficiency of manufacture in any desired ratio as between the consumer and the capitalist-manufacturer. In the nature of things it is very much simpler to arrange matters upon a scientific basis in so simple an undertaking as a gas company, which deals almost

exclusively in one staple commodity. The more complex the nature of the business, naturally the more difficult it would be to devise a sliding scale that would always hold the balance fairly as between the opposing interests of the investing proprietors and the customers concerned; but something more might be done in that direction than has hitherto been attempted.

The Interests of the Community.—Public regulation in the interests of the community is, as a rule, provided in a much more indirect way than by mere regulations as to the division of profits. It usually takes the form, rather, of insisting upon adequate arrangements being made for the health of employees, and for the health of those living in the immediate neighbourhood of the business. Financial considerations here hardly arise, if "the community" be regarded as something quite distinct from the possible customers. In so far as "the community" may all be possible customers, they have already been considered under the preceding heading.

The Interests of the Investor.—Passing on to the interests of investors, these are considered to some extent in connection with all Parliamentary companies, for before a private Act can be obtained, incorporating a Parliamentary company, due inquiry takes place as to the general scheme upon which it is proposed to carry on operations; and unless there is some reasonable likelihood of there being a sufficient demand for such an undertaking, a private Act is rarely granted. The supervision of Parliament, prior to the incorporation of any Parliamentary company, is sufficiently searching at all events to weed out all absolutely speculative undertakings, of the class that are regarded upon the Stock

Exchange as belonging to the "wild cat" species; but in connection with registered companies there is no corresponding inquiry into the merits of individual concerns before they are allowed the benefit of incorporation with limited liability.

Official Supervision of New Companies.—The idea of establishing some sort of official supervision, as a condition precedent to the registration of any limited company, was somewhat fully considered before the Companies Act of 1907 was passed, and it was—it is thought very properly—abandoned as unworkable. Certainly it would not be practicable to devise any scheme of scrutiny that would be really effective in all cases; and there can be little doubt that the establishment of an ineffective scheme of scrutiny would tend to make investors even more careless than they are at the present time when making inquiries before investing in new companies. Parliament therefore, very properly, went upon the lines, not of itself attempting to have every fresh scheme weighed in the balance, and either certified as "sound" or prohibited as "unsound"; but of insisting on a full disclosure of all material facts before allowing a company to invite applications for its capital. That full disclosure has to be made in the prospectus, and in cases where no prospectus is issued the full disclosure has still to be made in a document registered with the Registrar of Joint Stock Companies, so that those who like to take the trouble are now able to obtain access to information which at all events should be sufficient to enable them to weed out all those concerns that are obviously undesirable.

Forms of Control.—Coming back to public regulation and control on more general grounds, apart from the

powers directly exercised by Parliament in the case of Parliamentary companies, powers for specific purposes are exercised by various authorities, which may be regarded as acting as deputies for the Legislature. For instance, the Board of Trade has very large powers in connection with practically all Parliamentary companies, and also in connection with all insurance companies; and it exercises those powers partly from head-quarters and partly through inspectors. In the case of collieries again we have control through Government inspectors, designed chiefly if not entirely with a view to safeguarding the lives and limbs of employees working underground. The Home Office also exercises considerable control in connection with manufactures, generally through factory inspectors; and for some purposes power is given to the police, and for other purposes the power of control can only be exercised effectively through a magistrate, with a further appeal to the High Court, so that there are fairly adequate safeguards against any abuse arising through arbitrary action on the part of officials. Some forms of control, moreover, are exercised through the various local authorities, which in their turn are under control of the Local Government Board. These again are chiefly connected with matters of health and public safety.

Effect of Control.—In the great majority of cases the public control seems to have been instituted piecemeal, to meet particular abuses which it was found had grown up from time to time as a result of the absence of control, and that being so, there is little doubt that upon the whole these various regulations have been distinctly beneficial to all classes of the community. One may

perhaps go further, and say that, taking them *en bloc*, they have also been in the interests of business organisation and of business profits, for these various regulations have in almost all cases tended to increase working expenses, and in that way they have supplied a very powerful encouragement to the inventor to bring forward economising devices of various kinds. There can be little doubt that, but for the spur of increased expenses as a result of official control, many inventions that tend very considerably to reduce cost would not now be in existence—or at all events would not be in general use. Thus it is difficult to make out a good case in favour of the theory that business enterprise in this country has, so far, been crippled by State interference. At the same time there can be little doubt that, if public control were exercised with less discretion than it is, the risks of harm and loss would be considerably greater.

Uniform Accounts.—One form of control that has been applied—not by any means universally, but to selected industries—has been one stipulating that these particular concerns should prepare their periodical accounts upon a uniform basis. Up to the present uniform accounts are required in the case of railway companies, electric light companies, life insurance companies, building societies, and friendly societies, and there can be little doubt that very shortly uniform accounts will be provided for in the case of the more important local authorities. At the present time, for all practical purposes, uniform accounts in connection with what may be called the "minor" local authorities, because these authorities are subject to the audit of auditors appointed by the Local Government Board, and that (in effect) has gone a long way towards

producing uniformity of accounts. Now, it is obvious that, where concerns carrying on a similar business present their periodical accounts upon uniform lines, certain fairly definite advantages are secured. The arrangement stipulates for the issue of accounts which may fairly be described as adequate to the occasion (for it is only reasonable to assume that the prescribed form is at all events one of average suitability to its purpose), thus eliminating the possibility of manifestly inadequate accounts; moreover it secures, at all events theoretically, the advantage of enabling one to make a ready comparison of results as between one undertaking and another, which puts one in a far better position to criticise the management of the various undertakings. Instead of being limited to a comparison of present results with the past results in the same concern, uniform accounts enable one to compare the results of one undertaking with those of another. At the same time it must be borne in mind that, when comparing the results of one undertaking with another, one is practically certain to be comparing two dissimilar things; and unless one can make due allowance for all points of difference, it is quite likely that such comparison may be a mere waste of time. But the more effective the prescribed form of accounts may be, the easier will it be to make due allowance for all real points of difference; so this is no valid objection to uniformity of accounts *per se*, it merely emphasises the importance of making sure that the prescribed form is a suitable one.

Limited Nature of Provision as to Uniformity.—So far as prescribed forms of account in this country are concerned, it would seem that they are always hampered

in their usefulness by not going far enough. That is doubtless due to a disinclination to interfere unduly with private enterprise; but however commendable the idea may be—and doubtless is commendable in itself—it can be carried too far. For instance, uniformity of accounts in this country is a purely superficial uniformity. It never attempts to be anything more than a uniformity of the published periodical accounts. There is no attempt whatever at prescribing uniformity in means of record, and there is never any effective attempt at securing uniformity in the classification of items. It is only of quite recent years that the importance of the systematic classification of items has been duly appreciated by any one in this country; but due importance is now being given to the matter, at all events in some quarters; steps are now being taken in some few cases to insure that items of expense are not put down under three or four different headings in successive years. While there is no uniformity of classification, it is clear that a surface uniformity in the published accounts is a mere delusion, and that almost any desired result might be produced without departing from the specified form. To secure any reliable results, uniformity of classification is necessary to enable one to compare the published results of one concern with those of another concern in the same line. But we must also have uniformity of classification as between the two concerns, and so far as the author is aware, no attempt has yet been made in this country to secure anything of the kind. It may be of interest in this connection to note that recently an Inter-State Railway Commission has been appointed in the United States, with the object of securing some real uniformity

in accounting methods among all the railway companies operating in the States. The Commission has doubtless not yet got into full working order, but it has already published very detailed (and apparently very carefully compiled) vocabularies for the classification of all kinds of earnings and expenses; and so that there may be no excuse for inaccurate classification, it lays itself out to answer inquiries in all cases of doubt, and it publishes the results of such inquiries from time to time for the benefit of those similarly situated. All this shows that, if one likes to take the trouble, there are no insuperable difficulties in the way of securing a real, as well as a superficial, uniformity in accounting methods in any desired industry.

Drawbacks of Uniformity.—On the other hand, it is just as well to bear in mind the necessary disadvantages of prescribing uniform accounts. The most obvious disadvantage is that anything prescribed by a public authority must necessarily be more or less behind date. Any directions issued by a public body must be the result of the deliberations of a body which, in the nature of things, will not act as speedily as it is usual for business men to act when dealing with their own affairs. One may be pretty sure, therefore, that wherever uniformity is insisted upon, at all events in matters of detail which are capable of improvement—and few matters of detail are not capable of improvement—the authorised methods will always be inferior to the best known methods of the day. They will also, in the interests of uniformity, have to disregard the varying circumstances applying to individual concerns; and will necessarily have to stipulate that each concern shall do

something which is not the best possible thing for it to do, judged by itself; and further the existence of official regulations on matters of internal regulation will naturally tend to discourage further inquiry into improved methods, on account of the extreme difficulty of getting these improved methods authorised, even after their advantages have come to be understood. These circumstances, it is thought, militate against carrying uniformity into any very great detail. It seems best to rest content with uniformity in fundamental matters, and to allow individual concerns a reasonable amount of freedom to apply the "authorised" principles to suit their special requirements.

Here it may be permissible to point out a few defects in the prescribed forms that are at present in existence, as tending to show what is meant in this connection. In the case of railway companies, there is nothing in the prescribed form of accounts that will give any information to the inquirer as to the measure of success attending the management of railway hotels and refreshment rooms. In connection with gas companies, there is nothing in the official form to provide for the use of any material other than coal in the preparation of gas; and the provisions as to the sale of by-products are much more limited than modern methods of gas manufacture require. These difficulties may, of course, be got over in a way by allowing the prescribed form to be modified by each individual company; but this permission to modify of course does not tend towards uniformity, and so far as it exists it detracts from the advantages of uniformity. In the case of electric tramways, there is no prescribed form of accounts, but municipal tramway managers have among

themselves agreed upon a form that is very good, so far as it goes ; but the form they have agreed upon assumes that the tramway will make its own current, and does not provide for the possibility of purchasing electricity in bulk. In view of the fact that probably the majority of electric tramways do not make their own electricity, it would have been better to have arranged the Revenue Account in two sections—the first dealing with the manufacture of electricity, and the second with the running of the trams. Then those concerns that purchase their electricity would, of course, not have required to keep the first section of the Revenue Account, and all companies would have been able to produce the second section upon approximately uniform lines.

Effect of Control over Local Authorities.—In this connection it seems desirable to point out a few errors that have been brought into the accounts of local authorities as a result of the supervision of the Local Government Board. The supervision of local authorities by the Local Government Board is in itself highly desirable, and indeed experience has shown this to be the case ; but, for all that, it is as well to consider the undesirable results that it has also brought about, because these will at least prove useful, as indicating the dangers that are likely to arise from any considerable extension of the present system. The Local Government Board will not allow local authorities to borrow without its approval, or the approval of Parliament ; and in practice the approval of Parliament cannot be secured unless the approval of the Local Government Board has first been secured. Before authorising the raising of loans, the Local Government Board very naturally inquires into the objects upon which

it is proposed to spend the money, with a view to safeguarding investors and ratepayers. It fixes a term at the expiration of which the loan must be paid off, having regard to the objects and the nature of the proposed expenditure ; and, in order to make sure that the loan shall be paid off at the appointed day, it further stipulates that the local authority shall, from year to year, set aside, out of revenue, instalments to build up a Sinking Fund, to provide for the redemption of the loan at the end of the authorised period. Now, the authorised period is no doubt supposed to represent the average working life of the assets acquired with the proceeds of the loan ; that is to say, it is computed that at the end of the prescribed time further expenditure of practically the same amount will be necessary in order to keep things going ; but it is important to bear in mind that although, as a matter of arithmetic, it is quite easy to calculate the average working life of a miscellaneous collection of assets, one cannot so alter the nature of material objects as to give them all a working life of equal duration, when in point of fact they are by their nature of very varying durability. The result is that, although we have an official working life—an approximate life, sanctioned by a Government Department,—the true working life will remain precisely what it would have been, had no such calculation been attempted. Some assets will call for renewal very speedily ; others will call for renewal at a much more distant date. As each calls for renewal, it will have to be renewed. But the Local Government Board system is not elastic enough to provide for the raising of further loans as and when they may be necessary for renewal purposes. If any renewal should be called for

before the expiration of the authorised loan period, it is only possible to secure further loans for the purchase of these renewals with the sanction of the Local Government Board, and its usual practice, if a further loan is required for renewal purposes before the previous loan has been paid off, is only to authorise a new loan to the extent that provision has been made by Sinking Fund for the redemption of the loan on the original cost of the assets that now have to be renewed. Thus the effect of this particular form of Government control is to compel a local authority to charge its revenue not merely with the Sinking Fund instalments (which would agree with the proper provision for depreciation, if the calculation as to the average working life had been correct), but also with further charges from time to time for renewal purposes. This may—at all events from an academic point of view—be said to be "unfair" to the present generation of ratepayers, but that is after all only an academic discussion. The essential point is that the Local Government Board, having taken upon itself to say how the payment of the loan shall be provided for, is in the great majority of cases very naturally assumed to have gone thoroughly into the matter, and to have provided a scheme that really meets the case; whereas the Local Government Board's scheme does not protect the local authority against having to find heavy sums for renewal purposes out of revenue during the currency of the loan period. This is now being recognised by local authorities, and they are beginning to provide for it by making suitable reserves to equalise the cost of extraordinary renewals; but the practice in the past of not making this provision may fairly be said to be due to the fact

that the local authorities considered that the Local Government Board had gone fully into the problem, and had arrived at a solution that would work out quite satisfactorily in practice; whereas the Local Government Board's solution of the problem works out in practice very inadequately, because it makes very unequal charges against the revenue of successive years.

Another point where the Local Government Board's regulations conflict with the recognised principles of accounting is in the regulation not to allow a local authority ever to borrow money for the purpose of paying the wages of permanent employees. Clearly wages are ordinarily a revenue expense; but if a local authority, instead of employing a contractor to undertake capital expenditure, does the work itself, and puts its own employees on the one work; then, while they are exclusively engaged on that work, the amount paid to them in wages is capital expenditure. But if the local authority cannot borrow for that purpose, it is necessarily obliged to charge this portion of the capital expenditure against revenue. It must either do that—and some local authorities have been compelled to do it quite unexpectedly, so far as they were concerned—or, in the alternative, it must abandon doing capital expenditure work direct, and invariably get it done through a contractor. It is conceivable that in some cases that may in the long run be the most economical way of getting the work done; but whether it is so, or not, is a matter that ought to be considered solely upon its merits, without being hampered by official regulations as to borrowing powers.

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THE END

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